



NATIONAL BANK OF THE REPUBLIC OF NORTH MACEDONIA

Pursuant to Article 47 paragraph 1 item 6 of the Law on the National Bank of the Republic of Macedonia ("Official Gazette of the Republic of Macedonia" No. 158/2010), 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, 90/2009 and 67/2010), the National Bank of the Republic of Macedonia Council adopted the following

DECISION
on the methodology for determining capital adequacy
(Unofficial revised text)¹

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 a ratio between the bank's own funds, as determined in Section III of this Decision and the risk weighted assets, as determined by item 28 of this Decision.

3. The bank shall permanently maintain capital adequacy ratio of at least 8%.

The Governor of the National Bank of the Republic of Macedonia (hereinafter: the National Bank) may prescribe percentage higher than 8%, if it is required by the

¹ This is a revised text of the Decision on the methodology for determining capital adequacy. The revised text consists of the Decision on the methodology for determining capital adequacy (Official Gazette of the Republic of Macedonia No. 47/12), Decision on amending the Decision on the methodology for determining capital adequacy (Official Gazette of the Republic of Macedonia No. 50/13), the Decision on amending the Decision on the methodology for determining capital adequacy (Official Gazette of the Republic of North Macedonia No. 71/14), the Decision on amending the Decision on the methodology for determining capital adequacy (Official Gazette of the Republic of North Macedonia No. 223/15), the Decision on amending the Decision on the methodology for determining capital adequacy (Official Gazette of the Republic of North Macedonia No. 218/16), the Decision on amending the Decision on the methodology for determining capital adequacy (Official Gazette of the Republic of North Macedonia No. 218/18), the Decision on amending the Decision on the methodology for determining capital adequacy (Official Gazette of the Republic of North Macedonia No. 181/19), the Decision amending the Decision on the methodology for determining capital adequacy (Official Gazette of the Republic of North Macedonia No. 116/20), the Decision on amending the Decision on the methodology for determining capital adequacy (Official Gazette of the Republic of North Macedonia No. 167/20) and the Decision on amending the Decision on the methodology for determining capital adequacy (Official Gazette of the Republic of North Macedonia No. 27/24).

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 part of own funds required for covering a certain risk shall not be simultaneously used for covering other risks.

5. When the bank is subject to consolidated supervision and compiles consolidated financial reports for the banking group, the bank shall calculate capital adequacy both on individual and consolidated basis.

II. DEFINITIONS

6. Certain terminology used in this Decision shall denote the following:

1) **Intangible assets** shall be assets related to the incorporation, licensing, patents, subsidies and trademarks (including pre-agreements and their acquisition/utilization) and the Goodwill. Software or software in progress shall not be considered intangible assets. Intangible assets shall be presented in a net amount, less the amount of accumulated amortization and impairment losses;

2) **Trading book** shall include positions in financial instruments and goods held by the bank for trading (on own behalf and for own account and on behalf and for account of its clients), positions that occur when the bank receives an authorization to act as a market maker or positions held for hedging of other trading book positions. These positions are held to generate income from their sale in a short run and/or to generate income as a result of market price changes that have already occurred or are expected to occur;

3) **Banking book** shall include all positions not included in the bank's trading book;

4) **External credit assessment institution** (hereinafter: ECAI) shall be any legal entity that prepares and issues credit ratings on a professional basis;

5) **Recognized external credit assessment institution** (hereinafter: recognized ECAI) shall be any ECAI recognized by the National Bank according to Section XIII of this Decision as well as Fitch Ratings, Moody's Investors Services Ltd and Standard&Poor's Ratings Services;

6) **Selected ECAI** shall be any recognized ECAI whose credit ratings the bank decided to apply when determining the risk weight, in line with its internal acts;

7) **Recognized export crediting agency** (hereinafter: recognized ECA) shall include:

- Organization for European Co-operation and Development (OECD),
- An agency;

- a) whose domicile country is a signatory of the Arrangement on Guidelines for Officially Supported Export Credits, or
- b) which publishes its credit ratings and accepts the OECD methodology according to which the credit assessments are distributed in one of the eight credit quality levels based on the minimum export insurance premium;

8) **Credit rating** shall denote an assessment of creditworthiness of an entity (legal entity, government, local government, etc.), debt, debt instrument, preference share or other financial instrument or of the issuer of such instruments, developed and issued on the basis of established and defined ranking category system. Credit rating may be either requested or unrequested. **Requested credit rating** shall be considered any credit rating issued by a recognized ECAI at exclusive request of its client. Any other credit rating that has not been requested shall be regarded as **unrequested credit rating**;

- 9) **Market segments** shall include:
- Basic market segments,
 - A group of entities and/or financial instruments for which a recognized ECAI applies the same methodology and procedure for issuing, renewal or revocation of a credit rating.

Basic market segments shall include:

- Public finances - nonprofit public sector institutions (central government, public noncommercial institutions, local and regional government) and financial instruments issued by such entities (except for structured financial products),
- Trade companies - public or private sector legal entities that operate on a commercial basis and financial instruments issued by such persons (except for structured financial products),
- Structured financial products - all issued structured financial products, irrespective of their issuer, including securitization products.

10) **Central government** includes all government administrative sectors, as well as other central authorities financed by the central government budget, as specified by the legislation of their country. For the purposes of this Decision, central government in the Republic of Macedonia shall include:

- Legislature authority, i.e. the Assembly of the Republic of Macedonia;
- Executive authority, i.e. the President of the Republic of Macedonia, the Government and the ministries, and
- Judiciary authority, Constitutional court and other judicial entities and institutions;

11) **Local and regional government** shall include local and regional government authorities, as specified by the regulations of the respective country. In the Republic of Macedonia, local government shall include local government units (municipalities), including the City of Skopje and their authorities.

12) **Public sector entities** shall include entities for which the competent authority of their domicile countries determined a treatment of public sector entities (PSEs) or are incorporated in their domicile country as:

- Administrative authorities responsible to the central government, regional and local government;
- Nonprofit legal entities established by the central government and whose liabilities are guaranteed by the central government, including the local government bodies established by a special law and are under government scrutiny.

For the purposes of this Decision, public sector entities in the Republic of Macedonia shall include: public enterprises established by the central government, legal entities where the Republic of Macedonia is a major shareholder, public services and beneficiaries of the local government units' budget (schools, preschool institutions, museums, ZOOs, libraries, cultural centers, workers' universities, etc.), agencies and other institutions established by law, institutions financed by public funds and all other institutions and entities subject to government audit, as required by law.

Public sector entities enjoying a treatment of central government shall include:

- Public institutions from EU member states enjoying a status of a central government granted by the competent authority of the country;
- Public institutions in the Republic of Macedonia financed by the central budget of the Republic of Macedonia, i.e. the following authorities and institutions of the government administration:
 - a) independent bodies of the Government of the Republic of Macedonia: Agency of Youth and Sport, Emigration Agency, Commission for Relations with Religious Communities and Groups, Agency for Development and Investments, Crisis Management Center, Commodity Reserve Agency, Protection and Rescue Directorate, and other bodies;
 - b) bodies and institutions operating within ministries: Administration for Security and Counter Intelligence, State Labor Inspectorate, National Hydrological and Meteorological Services, Public Revenue Office, Custom Administration, Financial Intelligence Office, Financial Police Office, Financial Intelligence Office, Bureau for Public Security and other bodies;
 - c) administrative organizations: State Archives of the Republic of Macedonia, State Statistical Office and the Agency for Real Estate Cadastre and
 - d) other government administration authorities and organizations financed by the central budget.
- The Pension and Disability Insurance Fund of North Macedonia, the Health Insurance Fund of the Republic of North Macedonia and the Employment Service Agency of the Republic of North Macedonia;
- Development Bank of North Macedonia.

13) **Multilateral development bank** shall be an institution set up by at least three countries or with at least three member countries, whose main activity is to finance the economic development of all member countries of the institution or of only a group of countries. Also, multilateral development banks are: Inter-American Investment Corporation, Black Sea Trade and Development Bank and Central American Bank for Economic Integration.

14) **International organizations** shall include the European Community, the International Monetary Fund and the Bank for International Settlements;

15) **Small companies (hereinafter: SC)** shall be self-employed professionals who make earnings, irrespective of their form. SC shall include sole proprietors, natural persons who are not considered traders under the Law on Trade Companies and traders considered to be small and micro-traders under the Law on Trade Companies.

The Bank may also classify SC's clients by using internal classification, only if such classification does not require application of lower risk weight that would apply in case of use of the definition referred to in paragraph 1 of this sub-item.

16) **Nonperforming claim** shall be any exposure which under the Decision on credit risk management is regarded as nonperforming claim.

17) **High-risk claims** shall be exposures of banks that show objective indicators for occurrence of high risk, such as claims on/investments in private equity investments, venture capital firms, etc.;

18) **Residential property** shall be a family house or an apartment for residential purposes and construction land for building of family houses or apartments supported by construction license. Garage or parking place, basement, balcony, terrace, loggia or yard shall be considered a residential building if they are used as a collateral for a mortgage along with the family house or the apartment;

19) **Commercial real estate** shall be a business building (plant, administrative building, etc.), business facilities (shops, hotels, warehouses, etc.), garage or parking place or the yard intended for conducting business or commercial activity, and agricultural land and construction land intended for construction of a business building supported by a construction license. Business building shall be any building primarily used for conducting business activities. Garage or parking place or the yard shall be regarded as business building if they are either primarily used for conducting business activities or are used as a collateral for a mortgage together with the business building;

19-a) Commercial real estate shall be any property intended for performing certain business or commercial activity, with the exception of plants and related manufacturing facilities and agricultural land. Construction land shall be considered commercial real estate, if intended for building of commercial real estate and if supported by construction license. Garage or parking place or yard shall be considered commercial real estate, if they are pledged, along with the commercial real estate. The equipment in the commercial real estate shall be considered commercial real estate, if it is pledged, along with the commercial real estate, with the exception of office equipment, computers, furniture and other similar equipment.

20) **Cash items in process of collection** shall be funds in process of transfer from one bank into another and shall include cash on transfer accounts, cash underway and other forms of cash in process of collection;

21) **Credit risk mitigation instruments** shall be an instrument for decreasing the credit risk that meets criteria defined in section VI.2 of this Decision.

Credit risk mitigation instrument may be funded or nonfunded credit risk mitigation instrument;

22) **Secured claim** shall be considered any claim secured with credit mitigation instrument referred to in Section VI.2 of this Decision, without its carrying amount being reduced by the amount of accumulated depreciation, impairment, i.e. special reserve, premium or discount and effects of the change in fair value. Provided that only a part of the claim is secured by credit risk mitigation instrument referred to in section VI.2 of this Decision, such part shall represent the **secured part of the claim**. The remaining part of the claim shall represent the **unsecured part of the claim**;

23) **Currency risk** shall be a risk of loss caused by a change of exchange rates, change of value of Denar against other foreign currencies and changes in gold value.

24) **Market risks** shall include:

- Risk of investments in equity instruments which are a part of the trading book;
- Risk of investments in debt instruments which are a part of the trading book;
- Risk of noncompliance with exposure limits arising from trading book positions.

25) **Repo agreement** shall be an agreement on spot purchase/sale of securities or goods, binding the seller/purchaser to buy/sell back such or similar securities or goods on a specified later date at a predetermined price, with the following requirements being fulfilled:

- The Bank or the counterparty shall transfer the right of ownership of securities or goods;
- As agreed, the Bank shall not simultaneously transfer or pledge the securities or the goods to or with third parties, obliged to buy them back or to replace them for same or similar securities or goods.

26) **Agreement on lending securities or goods to counterparty and agreement on borrowing securities or goods from counterparty** shall be agreements allowing the Bank and its counterparty to transfer (or lend) securities or goods in exchange for adequate collateral, with an obligation for the party that borrowed the securities or goods to give back the same or similar securities or good on a later date or on call of the lender;

27) **Financial derivatives** shall be instruments whose value directly or indirectly depends on the price of securities, goods, stock exchange indices, currencies or interest rates subject to underlying financial instrument. These instruments shall be settled at some later date and no funds have been invested at the moment of their conclusion, or the amount invested is negligible;

28) **Equity instruments** shall include common shares with or without voting right, share certificate issued by depositary institution (e.g. SCD), convertible securities (securities convertible in shares), stakes in investment funds, stock exchange indices and positions in financial derivatives that refer to equity instruments;

29) **Debt instruments** shall include bonds, instruments traded on the money market and derivatives and other financial instruments that relate to interest rates and/or to other debt instruments;

30) **Underwriting and/or placement of issue of securities** implies an agreement binding the bank to organize and hold issue of securities for the account of issuer of securities and to underwrite and pay-in all securities or only those which remain unsubscribed, for the purpose of their further sale to potential investors, and placement of already issued securities in a new market. The bank shall treat likewise any agreement where it is a co-underwriter or member of a group of banks that underwrite issue of securities;

31) **Settlement/delivery risk** shall be a risk arising from transactions in debt instruments, equity instruments, currencies and goods that are not settled on the settlement date;

32) **Counterparty risk** shall denote a risk that the counterparty would not settle its cash liabilities to the bank on the basis of financial instruments, prior or on the settlement date.

33) **Free delivery** shall be any transaction settled such that one of the contracting party make payment/delivery before the other party meets its obligation. If such transaction is not settled on the settlement date specified in the agreement, the bank shall be exposed to risk of loss for the full amount of the payment/delivery.

34) **Premium on capital instruments sold** shall be the difference between the selling price and the nominal value of the capital instruments. Lower sales than nominal value of capital instruments shall mean negative premium on capital instruments sold. Higher sales than nominal value of capital instruments shall means positive premium on capital instruments sold.

35) **Financial sector entity** shall be a legal entity seated in the Republic of Macedonia or abroad which is a bank, non-banking financial institution or an ancillary banking services (if the company is included in the consolidated financial statements of the bank), under the Banking Law.

36) **Synthetic investment** shall be an investment in instruments whose value is directly related to the value of capital instruments issued by financial sector entities.

37) **Minority interest** shall cover positions from the Common Equity Tier I capital of a subsidiary owned by third parties that are not members of the banking group of the bank subject to consolidated supervision.

38) **A qualifying Additional Tier I capital and qualifying Tier II capital** shall include positions of the Additional Tier I and positions of Tier II of the subsidiary owned by third parties that are not members of the banking group of the bank subject to consolidated supervision.

39) **Significant investment** in financial sector entity shall be bank's investment that meets the following criteria:

- the bank's investment exceeds 10% of the Common Equity Tier I instruments issued by the financial sector entity;
- the bank has close connections with the financial sector entity, regardless of the amount of investment in capital instruments of the Common Equity Tier I capital of that entity;
- the bank has investments in Common Equity Tier I capital of the financial sector entity that is not a member of the banking group of the bank, but the financial sector entity and the bank are subject to consolidation under the accounting regulations and accounting standards.

All investments that do not meet at least one of the previous three criteria shall be considered investments in the financial sector **entities in which the bank has no significant investment**.

40) **Current income or current loss** shall be gain or loss on the bank's income statement, realized during a specific period shorter than one calendar year and before the decision of the bank's General Meeting of Shareholders, that confirms the financial result for the period.

41) **Year-end profit or loss** shall be gain or loss on the bank's income statement, realized during a calendar year and before the decision of the bank's General Meeting of Shareholders, that confirms the financial result for the year.

42) **Dividend payout ratio** shall be the amount of dividends paid to shareholders relative to the amount of profit after tax. If this ratio is negative or greater than 100%, the dividend payout ratio is 100%. If the profit after tax is zero, the dividend payout ratio is equal to: (1) 0% if there is no dividend payout or (2) 100%, if the bank paid out dividend.

43) **Distributable items** shall comprise the amount of profit after tax confirmed by the General Meeting of Shareholders or the amount of current income that qualifies for dividend distribution or payment of advance dividend under the law.

44) **Deferred tax assets that rely on bank's future profitability** shall be claims based on tax credits pursuant to tax regulations that can be offset against the tax liability of the bank, if the bank generates taxable profit in the future. **Deferred tax assets that rely on bank's future profitability and arise from temporary differences** shall be claims based on tax credits pursuant to tax regulations based on the temporary differences in the calculation of tax liabilities.

7. Terminology not defined in this Decision shall have the meaning defined in the Banking Law and in the bylaws adopted on the basis of this law.

III. OWN FUNDS

8. Banks' own funds shall be the sum of Tier I capital as defined by section III.1 of this decision and the Tier II capital as defined in section III.2 of this decision, taking into account the provisions of sections III.3 and III.4 of this decision.

9. Positions that do not to meet the requirements of this section may not be included in the calculation of bank's own funds.

Provided that the National Bank identifies that some of the positions the bank has included in the determining of own funds do not meet the requirements of this section, it shall immediately require from the bank to exclude such positions from the amount of own funds. Bank may include those positions in the determining of own funds, only when they meet the requirements and upon approval of the National Bank.

10. When determining the amount of own funds, the bank shall take into account the following rates:

- Common Equity Tier I capital must not be lower than 4.5% of the risk-weighted assets (Common Equity Tier I rate);
- Tier I capital must not be lower than 6% of the risk-weighted assets (Tier I capital rate).

III.1. Tier I capital

11. Bank's Tier I capital shall be the sum of the Common Equity Tier I capital as defined by section III.1.1 of this decision and the Additional Tier I capital as defined in section III.1.2 of this decision.

III.1.1 Common Equity Tier I capital

12. Common Equity Tier I capital shall be the sum of the positions of item 13 of this decision less the sum of deductions of item 16 of this decision and corrected for the regulatory adjustments in item 19-h of this decision.

13. The bank's Common Equity Tier I capital consists of the following:

13.1. capital instruments that meet the requirements of item 14 of this decision and approved as required by paragraph 2 of this item;

13.2. premium on capital instruments sold referred to in subitem 13.1 of this item;

13.3. mandatory general reserve (general reserve fund);

13.4. retained undistributed profit unencumbered by any future obligations, stated in the balance sheet of the bank and confirmed by decision of the General Meeting of Shareholders of the bank. The decision shall contain a provision that the retained profit is not available for payment of dividends to shareholders in the future. This position shall also include accumulated loss from previous years, with a negative sign;

13.5. current profit, or yearend profit that meets the requirements of item 15 of this decision; and

13.6. Accumulated other comprehensive income.

The positions of subitem 13.1 of paragraph 1 of this item shall be included in the Common Equity Tier I capital only upon approval of the National Bank. The bank shall, at least 30 days prior to the intention to include these instruments in the calculation of own funds, submit documentation that proves that the requirements laid down in item 14 of this decision are met.

The National Bank shall decide on the request for approval under paragraph 2 of this item, within 30 days upon completion of the documentation that proves that the requirements referred to in item 14 of this decision are met.

The positions of subitems 13.3, 13.4, 13.5 and 13.6 of paragraph 1 of this item shall be fully and immediately available to cover bank's operating risks and losses.

14. Capital instruments that meet the following requirements may be part of the Common Equity Tier I capital:

14.

14.1. to be issued by the bank on the basis of a decision of the General Meeting of Shareholders;

14.2. to be fully paid in, without their purchase being financed, directly or indirectly, by the bank;

14.3. to be treated as equity according to the accounting regulations and standards applicable to banks and to be completely and unlimitedly available to cover losses;

14.4. to be clearly and separately recognized in the bank's balance sheet;

14.5. to be unconditionally irreversible, without maturity date and irredeemable, unredeemable or irreducible in value, except in the case of bankruptcy or liquidation of the bank or upon approval of the National Bank, pursuant to item 19-I of this decision. As an exception, the requirements in this subitem shall be deemed to have been met if the value decreased as a result of a measure taken by the National Bank, as required by a law;

14.6. not to contain clauses or other provisions that allow for their redemption, repayment or reduction of their value, except in the case of bankruptcy or liquidation of the bank, and the bank has not prompted, at their issue, any expectations for their redemption, repayment or reduction of their value;

14.7. to have met the following conditions as regards the distributions to instrument holders:

- there is no preferential distribution treatment regarding the order of distribution payments, as well as in terms of other instruments that are part of the Common Equity Tier I capital;
- distributions to be payable only from distributable items;

- there are no provisions that limit the maximum level of distributions;
- the level of distributions does not depend on the purchase price of these instruments paid by the holders at their issuance;
- there is no obligation of regular payment of distributions;
- non-payment of distributions shall not be considered default of the bank;
- the cancellation of payment of the distribution does not impose any limits for the bank to make payments on other grounds.

14.8. to be of the highest quality compared to other capital instruments of the bank, or to be used first to cover any bank's operating loss and any capital instrument which is part of the Common Equity Tier I capital used *pari passu* to cover losses. This requirement is also considered to have been met in the case of write-off of the principal of capital instruments that are part of other components of the own funds;

14.9. in the case of bank's bankruptcy or liquidation, these instruments to be paid after all other liabilities of the bank to other creditors;

14.10. in the case of bankruptcy or liquidation of the bank, holders of these instruments to have the right to collect the rest of the bank's assets that remains after payment of other liabilities, with the right to collection being proportional to the share of the amount of issued instruments and the maximum amount of collection is not fixed or subject to a cap;

14.11. not to be collateralized or backed by any guarantee of the bank or connected entity that would reduce the level of subordination of these instruments as determined in subitems 14.8, 14.9 and 14.10 of this item;

14.12. not to be subject to any agreement that reduces the subordination of the instrument given in subitems 14.8, 14.9 and 14.10 of this item, in the case of bankruptcy or liquidation of the bank.

15. Current profit or year-end profit may be included in the calculation of Common Equity Tier I capital of the bank only upon approval of the National Bank.

The amount of current profit or year-end profit shall be reduced for the amount of paid dividend advance and/or dividend decided by the supervisory board of the bank to be distributed to its shareholders. If the supervisory board has not adopted a decision on payment of dividend, the current profit or year-end profit shall be reduced by whichever is higher of the following:

- dividends determined on the basis of the dividend payout ratio under the dividend policy of the bank;
- dividends determined on the basis of the average dividend payout ratio for the last three years;
- dividends determined on the basis of the dividend payout ratio from last year.

The National Bank shall issue the approval under paragraph 1 of this item if the following conditions are met:

- the amount of current profit or year-end profit was confirmed by audit company;
- the amount of current profit or year-end profit was reduced by any payment of dividend, tax or other similar liabilities paid from profits;
- the bank's supervisory board adopted a decision stipulating that the current profit or year-end profit will not be used for payment of dividend to shareholders.

To confirm the requirement under paragraph 3, indent 1 of this item, the bank shall submit:

- for the year-end profit - an audit report, prepared in accordance with the auditing regulations, or a letter from the auditor confirming that the audit of the annual financial statements is underway, but the auditor did not encounter any information that would be the basis for including a qualified opinion in the final report;
- for the current profit - an audit report or report on the verification of inter-periodic financial information prepared in consistence with auditing regulations, or an auditor's letter that the audit of the financial statements is underway, but the auditor did not encounter any information that would be a basis for including a qualified opinion in the final report.

To prove the fulfillment of the requirement of paragraph 3, indent 2 of this item, the bank shall submit:

- a statement signed by the person with special rights and responsibilities in the bank stating that income and expenses are presented in the income statement as required by the accounting regulations and accounting standards applicable to banks;
- a statement signed by the bank's management board members that shows each position in the current profit or year-end profit, including payments based on dividends, tax or other similar liabilities paid from the profit.

The National Bank shall decide on the request for issuing the approval under paragraph 1 of this item, within 30 days upon completing the documentation that proves the fulfillment of the requirements of this item.

The amount of current profit subject of the approval under paragraph 1 of this item may be included in the calculation of the Common Equity Tier I capital in the following periods of the current calendar year, only if the profit earned to the date of calculation of the Common Equity Tier I capital exceeds the amount of current profit subject of the approval of the National Bank.

16. Common Equity Tier I capital shall be reduced for the following deductions:

16.1 loss at the year-end or current loss;

16.2 intangible assets. The amount of deductions is reduced by deferred tax liabilities that would cease if intangible assets are damaged or derecognized as required by the accounting regulations and accounting standards applicable to banks.

The amount of deduction increases by the goodwill of the significant investments of the bank;

16.3 Deferred tax assets that rely on bank's future profitability. The amount of deductions is reduced by deferred tax liabilities only if the bank is empowered by law to offset current tax assets with current tax liabilities. When determining Common Equity Tier I capital on a consolidated basis, deferred tax liabilities can reduce the amount of deferred tax assets, only if deferred tax assets and deferred tax liabilities relate to taxes that are charged by the same tax institution and relate to the same taxable entity. Deferred tax liabilities that may be included in the netting of deferred tax assets do not include deferred tax liabilities of subitem 16.2 of this item;

16.4 The amount of direct, indirect and synthetic investments in own capital instruments of the Common Equity Tier I capital, including capital instruments that the bank is contractually required to purchase. The amount of deduction is equal to the gross long position of the bank in own capital instruments of the Common Equity Tier I capital and can be reduced by the amount of short position in these instruments only if: (1) the long and short position are in the same instrument and the short position does not expose the bank to counterparty risk and (2) both positions (long and short) are either part of the trading book or part of the banking book. In the case of investments in stock index that includes capital instruments of the bank, the amount of deduction is equal to the proportional share of these capital instruments in the index. If the bank has both long and short position in the stock index that includes capital instruments of the bank, the long position may be reduced by the amount of short position, including short position that exposes the bank to counterparty risk only if: (1) the long and the short position are in the same index and (2) both positions (long and short) are either part of the trading book or part of the banking book;

16.5 The amount of direct, indirect and synthetic investments in capital instruments of the Common Equity Tier I capital of the financial sector entities, where such entities have investments in the bank that artificially increase its own funds. The amount of deduction is equal to the gross long position of bank in capital instruments of the Common Equity Tier I capital of these entities;

16.6 The amount of direct, indirect and synthetic investments in capital instruments of the Common Equity Tier I capital of the financial sector entities in which the bank has no significant investment. The amount of total deduction for these investments is equal to the product of:

- direct, indirect and synthetic investments in capital instruments that are part of the own funds of the financial sector entities in which the bank has no significant investment, with a total amount exceeding 10% of the Common Equity Tier I capital of the bank. For the purposes of this indent, Common Equity Tier I capital of the bank is obtained when the sum of the positions referred to in item 13 of this decision will be adjusted for the regulatory adjustments in item 19-h of this decision and will be reduced for the deductions of subitems 16.1, 16.2, 16.3, 16.4, 16.5, 16.10 and 16.11 of this item, with the exception of the amount of deferred tax assets that rely on bank's future profitability and arise from temporary differences, and
- the amount of direct, indirect and synthetic investments in capital instruments of the Common Equity Tier I capital of the financial sector entities in which the bank has no significant investment, divided by the total amount of direct, indirect and synthetic investments in capital instruments

that are part of the own funds of the financial sector entities in which the bank has no significant investment.

Calculation of the amounts referred to in indents 1 and 2 of this subitem does not include direct, indirect and synthetic investments in capital instruments of financial sector entities in which the bank has no significant investments that are held up to five days. The amount of direct, indirect and synthetic investments referred to in paragraph 1 of this subitem which does not exceed 10% of the Common Equity Tier I capital of the bank is included in the calculation of the risk-weighted assets, in accordance with section VI of this decision;

16.7 The amount of direct, indirect and synthetic investments in capital instruments of the Common Equity Tier I capital of the financial sector entities in which the bank has a significant investment, with the exception of those held up to five days;

16.8 Amount of deductions from the Additional Tier I capital of item 19-c of this decision, which exceeds the total amount of Additional Tier I capital of item 19 of this decision;

16.9 Investments in non-financial institutions. The amount of deduction represents the amount exceeding the limits under the Banking Law pertaining to individual equity holding (15%) and the aggregate, i.e. total amount of equity holdings in nonfinancial institutions (30%). If the bank exceeds one of these limits, the amount exceeding the limit shall be taken as deductible. If the bank exceeds both limits, the higher amount of exceedances of both limits shall be taken as deductible. These limits do not take into account investments held up to five days, and securities registered in the bank's name and for account of other entities;

16.10 Tax costs that may be established at the time of calculation, unless the bank has adequately adjusted the amount of positions included in the Common Equity Tier I capital to the extent to which the tax costs would reduce the amount available to cover risks or losses;

16.11 Difference between impairment and special reserves established by the bank and the required amount of impairment and special reserves, according to the National Bank's credit risk management regulation.

17. The amount of deductions under item 16 subitems 16.6 and 16.7 of this decision is equal to the gross long position of the bank in these investments and can be reduced for the amount of short position in those investments only if the long and short positions relate to the same instrument, where: (1) the long and short positions have the same maturity or the residual maturity of the short position is at least one year and (2) both positions (long and short) are either part of the trading book or part of the banking book. In the case of investments in stock index that includes capital instruments of financial sector entities, the amount of deduction is equal to the proportional share of these capital instruments in the index.

The Bank is not required to include the following positions of item 16 subitems 16.3 and 16.7 of this decision, if their sum does not exceed the limit referred to in paragraph 3 of this item:

- deferred tax assets that rely on bank's future profitability arising from temporary differences, whose total amount does not exceed 10% of the Common Equity Tier I capital of the bank determined when the sum of the positions of item 13 of this decision is corrected for the regulatory adjustments of item 19-h of this decision and reduced for the deductions of item 16 subitems 16.1, 16.2, 16.3, 16.4, 16.5, 16.6, 16.10 and 16.11 of this decision, with the exception of the amount of deferred tax assets that rely on bank's future profitability and arise from temporary differences; and
- direct, indirect and synthetic investments in capital instruments of the Common Equity Tier I capital of financial sector entities in which the bank has a significant investment, whose total amount does not exceed 10% of the Common Equity Tier I capital of the bank determined when the sum of the positions of item 13 of this decision is corrected for the regulatory adjustments of item 19-h of this decision and reduced for the deductions of item 16 subitems 16.1, 16.2, 16.3, 16.4, 16.5, 16.6, 16.10 and 16.11 of this decision, with the exception of the amount of deferred tax assets that rely on bank's future profitability and arise from temporary differences.

For the purposes of paragraph 2 of this item, the limit is determined as the product of:

- the amount of Common Equity Tier I capital of the bank obtained when the sum of the positions referred to in item 13 of this decision is corrected for the regulatory adjustments of item 19-h of this decision and reduced for the deductions referred to in item 16 of this decision; and
- 17.65%.

The positions of paragraph 2 of this item which are not deductions from the Common Equity Tier I capital are included in the calculation of the credit risk weighted assets with risk weight of 250%.

III.1.2. Additional Tier I capital

18. Additional Tier I capital shall be the sum of the positions referred to in item 19 of this decision less the sum of deductions under item 19-c of this decision and corrected for the regulatory adjustments of item 19-h of this decision.

19. Additional Tier I capital of the bank shall include the following positions:
- capital instruments that meet the criteria of section 19-a of this decision; and
 - premium on sale of capital instruments referred to in indent 1 of this item.

19 a. Additional Tier I capital may include capital instruments that meet the following requirements:

19-a.1. are issued and fully paid in, without their purchase being financed, directly or indirectly, by the bank;

19-a.2. are not purchased by the bank, its subsidiary or entity where the bank has a participation in the form of ownership;

19-a.3. are paid after the instruments that are part of Tier II capital of the bank, in case of bankruptcy or liquidation of the bank;

19-a.4. are not collateralized or backed by any guarantee by the bank or connected person/entity, which would reduce the subordination level of these instruments which is specified in subitem 19-a.3 of this item;

19-a.5. are not subject to any contract that reduces the subordination level specified in subitem 19-a.3 of this item, in case of bankruptcy or liquidation of the bank;

19-a.6. have no maturity date;

19-a.7. in cases of one or more redemption or repayment options of the instrument, the use of redemption or repayment option is the sole discretion of the issuer;

19-a.8. can be redeemed or repaid by the bank only upon approval of the National Bank, in accordance with item 19-I of this decision.

19-a.9. there are no clauses or other provisions that would require instruments to be redeemable or repayable except in the case of bankruptcy or liquidation of the bank or upon approval of the National Bank, in accordance with item 19-I of this decision;

19-a.10. the bank does not encourage expectations that the National Bank will issue the approval for redemption or repayment of the instruments;

19-a.11. the following conditions applicable to distributions to holders of capital instruments are met:

- the distributions is paid from the distributable items, where the payment of compensation can be made if the profit is not audited by certified auditor;
- the level of distributions should not be amended on the basis of the credit standing of the bank or the credit standing of its parent entity;
- the bank has full discretion at all time to cancel the distributions for an unlimited period and on a non-cumulative basis and without restrictions to use such cancelled payments of distributions to meet its obligations;
- cancellation of distributions is not considered a default of the bank;
- the cancellation of distributions imposes no restrictions on the bank to make other payments;

19-a.12. are not taken into account when determining whether the requirements for opening of bankruptcy proceedings in accordance with law are met;

19-a.13. contain provisions that stipulate that in the case of a trigger event, the value of principal of these instruments is written down or reduced on a permanent or temporary basis or the instrument be converted to Common Equity Tier I instrument;

19-a.14. the instrument must not have characteristics that could hinder the recapitalization of the bank;

19-a.15. in cases when the instrument is not directly issued by the bank: (1) it is issued by an entity who is a member of the banking group of the bank and (2) cash paid is immediately available to the bank without any restrictions, whereby all other conditions laid down in this item are met;

19-a.16. capital instrument is not treated as a deposit (savings) and is not insured by the Deposit Insurance Fund.

19-b. To meet the conditions of item 19-a subitem 19-a.11 indent 5 and subitem 19-a.14 of this decision, the instrument shall not contain provisions that provide for: (1) mandatory payment of the distributions in the case of payment of distributions for instruments with the same or higher quality, including the Common Equity Tier I instruments; (2) mandatory cancellation of the payment of distributions for the other instruments of the Common Equity Tier I capital, Additional Tier I capital and Tier II capital, if it is not paid for the compensation for the instrument; (3) an obligation to substitute the payment of interest or dividend by a payment in any other form.

To meet the condition of item 19-a subitem 19-a.13 of this decision, the instrument arrangement shall include the following provisions:

- the trigger event is defined as a reduction in the Common Equity Tier I capital ratio below 5.125%. The bank may set a higher level of trigger event or beside such trigger event, to determine other trigger events;
- the write-down i.e. conversion creates instruments, i.e. positions that may be part of the Common Equity Tier I capital in accordance with III.1.1 of this section,
- in the case of conversion of an instrument of the Additional Tier I capital into capital instrument of the Common Equity Tier I capital, the provisions should specify: (1) the rate of such conversion and the maximum permitted amount that can be converted into Common Equity Tier I instrument or (2) the range within which the instrument will be converted into Common Equity Tier I instrument, taking into account price movements of the instruments;
- in the case of write-down i.e. depreciation of the principal amount of the Additional Tier I instrument, the reduction applies to: (1) the claim of the holder of the instrument, in the case of bankruptcy or liquidation of the bank; (2) the amount required to be paid in the event of the call or redemption of the instrument and (3) the distributions made on the instrument.

The total amount of instruments of the Additional Tier I capital which is written down or converted into Common Equity Tier I instruments after the trigger event, cannot be less than the lower amount between: (1) the amount required for achieving Common Equity Tier I capital ratio of 5.125% and (2) the full principal amount of the instrument.

In the case of trigger event, the bank should:

- 1) immediately inform the National Bank;
- 2) inform the holders of the instruments; and
- 3) write down the principal amount of the instruments, or convert them into positions of the Common Equity Tier I capital within 30 days after the trigger event.

The Bank shall:

- consistently hold common shares in an amount that is sufficient to convert the instruments of the Additional Tier I capital in capital instruments of the Common Equity Tier I capital;
- on the date of issue of the instruments of the Additional Tier I capital, provide all the approvals from the relevant authority, as required by law;
- at any time, have the approvals from the relevant authority competent to issue instruments of the Common Equity Tier I capital by converting the instruments of the Additional Tier I capital, in accordance with law.

In the case of write down or depreciation of the principal amount, the write down shall be made proportionally to all instruments of item 19-a of this decision.

The instruments under item 19-a of this decision may be written down on a temporary basis only if the following conditions are met:

- the amount of distributions upon write down is calculated on the basis of the depreciated principal amount of the instrument;
- the instrument principal amount may increase only from profits after tax, as confirmed by the General Meeting of Shareholders;
- the bank has full discretion in deciding to increase the instrument principal amount or to pay compensation for the depreciated principal amount;
- instrument principal amount is increased proportionally to all instruments under item 19-a of this decision, that were subject to temporary write down;
- the maximum amount of increase in the instrument principal amount along with the amount of distributions to the depreciated principal amount is determined on the date of the increase in the principal amount of these instruments and is equal to the product of the profit after tax and the share of the nominal amount (before write down) of the instruments referred to in item 19-a of this decision, that were subject to temporary write down and the total amount of Tier I capital of the bank;
- the increased instrument principal amount and the compensation payable to the depreciated principal amount decrease the amount of Common Equity Tier I and the maximum amount for the banks' distributable items.

19.c. Additional Tier I capital is reduced for the following positions:

19-c.1. The amount of direct, indirect and synthetic investments in own capital instruments of the Additional Tier I capital, including capital instruments for which the bank has a contractual obligation to buy. In determining this amount, the bank shall properly apply the provisions of item 16 subitem 16.4 of this decision;

19-c.2. The amount of direct, indirect and synthetic investments in capital instruments of the Additional Tier I capital of financial sector entities, where such entities have investments in the bank that artificially increase its own funds. The amount of deduction is equal to the gross long position of the bank in the capital instruments of the Additional Tier I capital of these entities;

19-c.3. The amount of direct, indirect and synthetic investments in capital instruments of the Additional Tier I capital of the financial sector entities where the bank has no significant investment. In determining this amount, the bank shall properly apply the provisions of item 16 subitem 16.6 and item 17 paragraph 1 of this decision;

19-c.4. The amount of direct, indirect and synthetic investments in capital instruments of the Additional Tier I capital of the financial sector entities where the bank has a significant investment, with the exception of those held up to five days. In determining this amount, the bank shall properly apply the provisions of item 17 paragraph 1 of this decision;

19-c.5. Amount of deductions from the Tier II capital of item 19-g of this decision, which exceeds the total amount of Tier II capital of item 19-e of this decision.

19-c.6. Tax costs that may be determined at the time of calculation, unless the bank has adequately adjusted the amount of the positions included in the Additional Tier I capital to the extent that the tax costs would reduce the amount available to cover risks or losses.

III.2 Tier II capital

19-d. Tier II capital is the sum of the positions referred to in item 19-e of this decision less the deductions referred to in item 19-g of this decision and corrected for the regulatory adjustments of item 19-h of this decision.

19-e. Tier II capital of the bank includes the following positions:

- capital instruments and subordinated loans that meet the criteria of item 19-f of this decision; and
- premium on capital instruments sold referred to in indent 1 of this item.

19-f. Capital instruments and subordinated loans may be part of Tier II capital if:

19-f.1. issued by or credited to the bank and fully paid-in;

19-f.2. not purchased or approved by the bank, its subsidiary or entity in which the Bank has participation in the form of ownership;

19-f.3. the purchase or approval of these instruments is not funded directly or indirectly by the bank;

19-f.4. liabilities based on these instruments are fully subject to the liabilities to depositors and other creditors of the bank;

19-f.5. not collateralized or backed by any guarantee by the bank or any connected person/entity, which would reduce the level of subordination of these instruments as defined in subitem 19-f.4 of this item;

19-f.6. not subject to any agreement that reduces the subordination level specified in subitem 19-f.4 of this item;

19-f.7. have a maturity of at least five years;

19-f.8. in the case of one or more options for redemption or prepayment, the utilization of redemption/prepayment option is at the discretion only of the issuer;

19-f.9. redeemable or prematurely payable only upon approval of the National Bank, in accordance with section 19-l of this decision;

19-f.10. do not contain clauses or other type of provisions, and the bank does not encourage expectations that the instruments will be redeemed or prepaid, except in case of bankruptcy or liquidation of the bank;

19-f.11. do not contain clauses or other type of provisions that entitle the holders of these instruments to require accelerated repayment of future claims based on interest or principal amount, except in case of bankruptcy or liquidation;

19-f.12. the level of interest or dividends is not changed depending on the credit standing of the bank or the credit standing of its parent entity;

19-f.13. in cases where no directly issued by the bank, i.e. not credited directly to the bank: (1) issued by, i.e. credited to an entity that is a member of the banking group of the bank and (2) cash paid is immediately available to the bank without any restriction, thus meeting all the other requirements laid down in this item;

19-f.14. not treated as deposits (savings) and not insured by the Deposit Insurance Fund.

The amount of the instruments of paragraph 1 of this item included in the calculation of Tier II capital of the bank over the final five years to its maturity, shall be the product of:

- the nominal amount of the position on the first day of the final five years to the contractual maturity;
- The number of remaining calendar days of the contractual maturity of the position, divided by the total number of calendar days in the period of the final five years.

19-g. Tier II capital shall be reduced by the following positions:

19-g.1. The amount of direct, indirect and synthetic investments in own instruments of the Tier II capital, including the instruments for which the bank has a contractual obligation to buy. In determining this amount, the bank shall properly apply the provisions of item 16 subitem 16.4 of this decision;

19-g.2. The amount of direct, indirect and synthetic investments in Tier II capital positions of financial sector entities, where such entities have investments in the bank that artificially increase its own funds. The amount of deduction is equal to the gross long position of the bank in the Tier II capital position of these entities;

19-g.3. The amount of direct, indirect and synthetic investments in Tier II capital positions of financial sector entities where the bank has no significant investment. In determining this amount, the bank shall properly apply the provisions of item 16 subitem 16.6 and item 17 paragraph 1 of this decision;

19-g.4. The amount of direct, indirect and synthetic investments in Tier II capital positions of financial sector entities where the bank has a significant investment, with the exception of those held up to five days. In determining this amount, the bank shall properly apply the provisions of item 17 paragraph 1 of this decision.

III.3 Regulatory adjustments

19-h. The bank does not include the following items in the calculation of the individual components of own funds:

- any increase in individual components of own funds which stems from securitization positions;
- gains or losses from protection against cash flow risk;
- gains or losses on bank's liabilities measured at fair value, resulting from changes in the creditworthiness of the bank;
- gains or losses related to liabilities arising from derivatives measured at fair value, resulting from changes in the creditworthiness of the bank, where these gains and losses cannot be offset with those arising from counterparty risk.

Notwithstanding paragraph 1, indent 3 of this item, the bank may include gains and losses on liabilities that are measured at fair value in the case of bonds issued by the bank and are at all times backed by the bank's claims (covered bonds), whereby there is a high correlation between changes in the value of bonds and changes in the value of the covered claims of the bank, i.e. changes in the value of the bonds result from changes in the creditworthiness of the bank.

III.4. Other provisions

19.i. Before including the positions of items 19-a and 19-f of this decision in the calculation of own funds, the bank shall notify the National Bank of the conditions under which they have occurred and submit documentation confirming that the conditions prescribed in this decision for the respective position are met, at least 30 days before the intention to include these positions in the calculation of own funds. In addition, the bank shall also submit:

- calculation of the level of own funds and the capital adequacy ratio before and after the inclusion of these positions in the calculation of own funds as of the reporting date;
- forecast of the total internal capital for covering risks, including capital buffers for the next three years;
- forecast of the bank's income and expenses that takes into account the effect of using positions, at least for the next three years.

The bank may not include certain positions in the calculation of own funds, which according to items 16, 19-c and 19-g of this decision are considered deductions, if they are temporary positions and if the bank has an approval of the National Bank. The approval of the National Bank shall specify the period in which the bank may not include those positions as deduction in the calculation of own funds.

19-j. The distributions to instruments of the Common Equity Tier I capital, the Additional Tier I capital and the Tier II capital may be in cash or in the form of an instrument that can be part of the bank's own funds.

19-k. In the deductions of item 16 subitems 16.5, 16.6, 16.7, item 19-c subitems 19-c.2, 19-c.3, 19-c.4 and item 19-g subitems 19-g.2, 19-g.3 and 19-g.4 of this decision, the bank shall include only direct, indirect and synthetic investments in positions of financial sector entities who, in accordance with the regulations governing the operation of these entities, have treatment of regulatory capital.

All other instruments that do not meet the requirement of paragraph 1 of this item shall be included in the calculation of risk-weighted assets in accordance with section VI of this decision.

The bank shall allocate the positions referred to in paragraph 1 of this item to the deductions of the Common Equity Tier I capital, Additional Tier I capital or Tier II capital, taking into account their quality, as specified in the respective regulation that governs the operation of these entities.

If the allocation referred to in paragraph 3 of this item cannot be made on the basis of the regulation governing the operations of financial sector entities, the positions referred to in paragraph 1 of this item shall be deducted from the Common Equity Tier I of the bank.

19-l. Without the approval of the National Bank, the bank may not reduce the amount of own funds by:

- 1) redeeming or reducing the amount of instruments that are part of the Common Equity Tier I capital;
- 2) redeeming or repaying the instruments that are part of the Additional Tier I capital;
- 3) redeeming or repaying the instruments that are part of the Tier II capital, before the contractual maturity

Notwithstanding paragraph 1 of this item, the bank may redeem instruments that are part of the Common Equity Tier I capital without the approval of the National

Bank if the amount of the total instruments redeemed does not exceed 1% of the total amount of such kind of instruments issued by the bank.

The bank may not announce the depreciation, redemption or early repayment of the positions referred to in paragraph 1 of this item before obtaining the necessary approval by the National Bank.

The National Bank shall issue the approval referred to in paragraph 1 of this item if at least five years have passed since the date of issuance/approval of the instrument and if:

- the bank replaces this instrument with a new instrument with the same or better quality, where the replacement cost does not jeopardize the bank's capacity for profitable operations, and/or,
- the bank can prove that its own funds, after their reduction due to the activities referred to in paragraph 1 of this item, will exceed the required level, taking into account the provisions of item 10 of this decision, the total internal capital for covering risks and capital buffers.

For the purposes of paragraph 4 indent 1 of this item, the replacement cost does not jeopardize the bank's capacity for profitable operations if the cost of the new instrument is not significantly higher than the cost of the bank for the instrument replaced, thus allowing the bank to keep or increase its profitability.

Notwithstanding paragraph 4 of this item, the National Bank may issue an approval for the redemption or early repayment of the instruments that are part of the Additional Tier I capital and Tier II capital before the expiration of five years from the date of their issue/approval, only if the requirements referred to in paragraph 4, indents 1 and 2 of this item are met, and if:

- due to regulatory changes these instruments are excluded from their own funds or deployed in lower quality positions;
- there are changes in the tax treatment of these instruments, and the bank can prove that these are significant changes that could not have been foreseen at the moment of issuing/approving the instruments.

In order to obtain the approval referred to in paragraphs 4 and 6 of this item, the bank shall, at least three months prior to the implementation of the activities referred to in paragraph 1 of this item, submit to the National Bank at least:

- detailed explanation of the reasons for carrying out the activities referred to in paragraph 1 of this item;
- forecast of the level of capital requirement for covering risks for a period of at least three years, taking into account the bank's business policy;
- structure of own funds before and after the implementation of the activities referred to in paragraph 1 of this item;
- profitability forecast for the next three years, taking into account the instrument replacement cost;

- assessment of risks the bank is or could be exposed to and assessment of whether its own funds are at a level that ensures coverage of such risks, including the results of the stress tests performed by the bank.

IV. TRADING BOOK AND BANKING BOOK

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

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

In order to be included in the trading book, the positions in the financial instruments and goods must be released from any restrictive provisions that limit their availability for trade or protect their value.

22. Positions that meet criteria specified by this section and item 6 sub-item 2) of this Decision, shall be included in the trading book, as follows:

- a) Financial instruments:
 - equity instruments,
 - debt instruments,
 - financial derivatives (futures contracts and forward agreements, options, swaps, etc.).
- b) repo agreements and agreements on lending securities or goods to counterparty,
- c) agreements on borrowing securities or goods from counterparty,
- d) commissions, fees, interests, dividends and margins based on financial derivatives traded on the stock exchange, directly related to trading book positions,
- e) exposure arising from agreement on underwriting and/or placement of issue of securities.

23. The bank may include the exposure arising from reverse repo agreements for purchasing securities or goods (reverse repos), and agreements on borrowing securities or goods 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 is adjusted for each change in the value of the underlying securities or goods,
- the contract provides 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 with credit quality level of at least 2, a stock exchange or a clearing house,

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

In the event of default of the counterparty to the agreements referred to in paragraph 1 of this item, the bank shall notify the National Bank forthwith.

24. By way of derogation from item 22 of this Decision, inherent financial derivatives which according to the Methodology for recording and evaluating accounting items and for preparation of financial statements are considered to be a special financial instrument and which do not meet the requirements specified by this section shall not be included in the trading book.

The bank shall manage any risk arising from instruments referred to in paragraph 1 of this item, and if necessary, include them when determining the capital requirement for covering other risks.

25. The bank shall establish and apply appropriate written policies for allocation of a particular item in the trading book or in the banking book. The assumptions for allocating certain item in the trading book or in the banking book and their application should be properly documented, be applied on a consistent basis and be subject to regular internal audit.

26. When the National Bank considers that a financial instrument, which is a part of the trading book, does not meet the criteria specified by this section and is not used for trading, it shall require from the bank to exclude such instrument from the trading book, regardless of its accounting treatment.

If the National Bank considers that a financial instrument, which is not a part of the trading book, does meet the criteria specified by this section and is used for trading, it shall require from the bank to include such instrument in the trading book, regardless of its accounting treatment.

V. CAPITAL REQUIREMENT FOR COVERING RISKS

27. The capital requirements for covering risks shall be the sum of:
- the capital requirement for credit risk, as defined by section VI of this Decision,
 - the capital requirement for currency risk, as defined by section VII of this Decision,
 - the capital requirement for market risks, as defined by section VIII of this Decision,
 - the capital requirement for settlement/delivery risk, as specified by section VIII-a of this Decision,
 - the capital requirement for counterparty risk, as defined by section VIII-b of this Decision,
 - the capital requirement for commodity risk, as defined by Section IX of this Decision, and
 - the capital requirement for operating risk, as defined by section X 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 National Bank considers it to be necessary for the nature, the type and the volume of bank's activities (e.g. liquidity risk, interest rate risk arising from the banking book, concentration risk, etc.).

28. Risk weighted assets shall be obtained by multiplying the capital requirement for covering risks, as defined under item 27 of this decision, with 12.5.

29. By way of derogation from 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 foreign exchange position, as specified by Section VII of this Decision, does not exceed 2% of its own funds.

30. By way of derogation from item 27 of this Decision, the bank shall not calculate and hold capital requirements for market risks if:

- the amount of bank's trading book positions usually does not exceed 5% of its overall operations and simultaneously does not exceed Denar 915 million, and
- the amount of bank's total trading book positions never exceeds 6% of its overall activities and simultaneously does not exceed Denar 1,220 million.

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

31. The bank, which more than three times in 30 days exceeds the limit referred to in item 30, paragraph 1 indent 1, but does not exceed the limit referred to in item 30, paragraph 1 indent 2, shall submit to the National Bank a report showing daily and average monthly values of the trading book activities in absolute amount and the share in overall operations, including an explanation for such excess. The bank shall submit the report within three days following the day of the third excess of limit. Having examined the data and the explanation submitted by the bank, the National Bank shall, within ten working days, decide whether the bank should start calculating the capital requirement for market risks.

32. The bank, which exceeds the limit referred to in item 30, paragraph 1 indent 2, shall immediately (no later than one working day) notify the National Bank on the excess of limit and the reasons behind. The National Bank shall, within ten working days, set the date on which the bank is to start calculating the capital requirement for market risks, unless the explanation indicates that the reason behind the excess of limit under item 30 paragraph 1 indent 2 is of extraordinary nature.

33. The bank, which in accordance with items 30, 31 and 32, is exempted from calculating capital requirement for market risks, shall calculate capital requirement for credit risk for the trading book positions.

34. For the purpose of adequate calculation of 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 the net position in gold and its aggregate

foreign currency position, and provide adequate documentation reflecting the movement of these amounts.

VI. CREDIT RISK WEIGHTED ASSETS

35. The bank shall distribute on-balance sheet and off-balance sheet claims in corresponding exposure categories, as defined by item 37 of this Decision and assign adequate risk weight depending on the level of credit quality of the debtor or the claim, as determined by section VI of this Decision.

On-balance sheet and off-balance sheet claims shall be presented in a net amount, as a difference between their accounting value and the respective impairment, i.e. special reserve, premium or discount and the effects of the change in fair value (without taking into account the accumulated depreciation).

When certain claim consists of secured and unsecured part, the impairment i.e. special reserve shall first be allocated to the unsecured part of the claim.

36. Credit quality level that serves as a basis for using adequate risk weight shall be determined on the basis of debtor's credit rating or the claim as determined by recognized ECAI, as specified by sections VI and XII of this Decision.

By way of derogation from paragraph 1 of this item, the bank may use the credit rating given by recognized ECA for certain exposure categories specified by this Decision.

In case of force majeure (war, natural disasters and other contingencies in the country), the Governor of the National Bank may also assign higher risk weights for certain bank's claims.

37. For the purposes of this Decision, the bank shall distribute each on-balance sheet and off-balance sheet position which is not a part of the trading book in one of the following categories of exposure/positions:

- 1) Claims on central governments and central banks;
- 2) Claims on local and regional government;
- 3) Claims on public sector entities;
- 4) Claims on multilateral development banks and international organizations;
- 5) Claims on banks;
- 6) Claims on other trade companies;
- 7) Retail portfolio;
- 8) Claims secured by residential property;
- 9) Claims secured by commercial real estate;
- 10) Nonperforming claims;
- 11) High risk claims;
- 12) Stakes in investment funds;
- 13) Other positions.

38. Prior to the allocation of off-balance sheet claims in the categories of item 37 of this Decision, the bank shall convert off-balance sheet claims into on-balance sheet claims, by using conversion factors referred to in paragraph 2 of this item.

The conversion factor level depends on the risk level of each off-balance sheet claim as follows:

- 1) 0% for low risk off-balance sheet claims;
- 2) 20% for medium/low risk off-balance sheet claims;
- 3) 50% for medium risk off-balance sheet claims;
- 4) 100% for high risk off-balance sheet claims.

Low risk off-balance sheet claims shall include:

- Undertaken off-balance sheet credit facilities which the bank may cancel unconditionally at any time without notice to the debtor or that do effectively provide for automatic cancellation due to deterioration in a borrower's creditworthiness or fully covered, i.e. bear no credit risk (undrawn unconditionally cancellable credit lines at any time by the bank without notice; guarantees, letters of credits or other off-balance sheet positions backed by Denar or foreign currency funds, etc.). Bank's liabilities arising from agreement on credit line approved to natural person may be considered as low risk off-balance sheet claim, only if the agreement or consumer protection regulations (including the regulations for consumer protection in case of consumer loans) permit cancellation of such liabilities by the bank;

Medium/low risk off-balance sheet claims shall include:

- Undertaken off-balance sheet liabilities based on open documentary letters of credit which are confirmed and where the goods paid by means of letter of credit serves as a collateral instrument and other undertaken off-balance liabilities based on other agreements collateralized similarly,
- Undertaken off-balance sheet credit liabilities (e.g. undrawn irrevocable credit lines based on overdrafts, credit cards and other similar type of potential credit risk exposure) with maturity/validity of up one year, which the bank may not cancel unconditionally without notice to the debtor or that do not effectively provide for automatic cancellation of liability due to deterioration in a borrower's creditworthiness,
- undertaken off-balance sheet liabilities based on performance guarantees and tender participation guarantees (including guarantees associated with these guarantees, such as guarantees for the return of advance payment) and all other guarantees that ensure certain performance, i.e. which do not guarantee fulfilment of certain credit obligation by the borrower.

Medium risk off-balance sheet claims shall include:

- Undertaken off-balance sheet liabilities based on open documentary letters of credits confirmed, other than documentary letters of credits included in the medium/low risk off-balance sheet positions,
- undertaken off-balance sheet liabilities based on customs guarantees, tax payment guarantees and transport/transit guarantees;
- undertaken off-balance sheet liabilities (uncovered guarantees and letters of credit) for payment in case of default by the debtor for payment towards third party arising from certain business relation, with the exception of guarantees that guarantee credit relation,
- Undertaken off-balance sheet credit liabilities (e.g. undrawn irrevocable credit lines based on overdrafts, credit cards and other similar type of potential credit risk exposure) with maturity/validity of more than a year,

which the bank may not cancel unconditionally without notice to the debtor or that do not effectively provide for automatic cancellation of liability due to deterioration in a borrower's creditworthiness.

High risk off-balance sheet claims shall include:

- Uncovered guarantees (not elsewhere classified) that guarantee fulfilment of certain credit obligation by the borrower,
- Undertaken off-balance sheet liabilities based on credit derivative agreements,
- Undertaken off-balance sheet liabilities based on accepting and providing a guarantee of a bill,
- Undertaken off-balance sheet liabilities based on activities that provide a right of recourse,
- Undertaken off-balance sheet liabilities based on asset sale and repurchase agreements,
- Undertaken off-balance sheet liabilities to credit related to assumed potential liabilities.

39. By way of derogation from section VI.1 of this Decision, a bank may apply 0% risk weight to claims on debtor seated in the Republic of Macedonia which is a parent entity or bank's subsidiary, subsidiary of the bank's parent entity or an entity considered to be connected to the bank as defined by the Banking Law, if:

- The debtor is either a bank or a financial holding company, financial institution or ancillary service company of a bank, governed by capital adequacy regulation, which is at least equal to the methodology specified by this Decision;
- The debtor and the bank belong to a same banking group and are subject to consolidation by using a method of full consolidation;
- The debtor applies risk management policies and procedures which are not different from those used by the bank; and
- There are no current or expected material or legal restrictions for timely transfer of cash in the form of capital or for payment of a debtor's liabilities to the bank.

By way of derogation from section VI.1 of this Decision, a bank may apply 0% risk weight to claims on funds established (fully) by one or more central governments, multilateral development banks, or public sector entities with a treatment of central government, on which, according to this Decision, risk weight of 0% is applied, and the only source of finance for these funds are the funds paid by these institutions in form of stakes (non leveraged).

40. By way of derogation from section VI.1 of this Decision, 0% risk weight shall apply to deductions of the Common Equity Tier I capital, Additional Tier I capital and supplementary capital of a bank which are on-balance sheet claims.

41. When a claim is collateralized by credit risk mitigation instrument, the risk weight, i.e. the amount of claim shall be determined as specified by section VI.2 of this Decision.

42. If no method of determining risk weight has been defined for some on-balance sheet or off-balance sheet claims, the bank shall apply 100% risk weight to such exposure.

The claims for which the National Bank has determined inadequate categorization in a lower risk weight, i.e. lower conversion factor, in the next two years the bank is obliged to apply the risk weight, i.e. the conversion factor which it should have applied in accordance with the provisions of this Decision, notwithstanding, the conditions for applying a lower risk weight i.e. conversion factor are fulfilled during those two years, unless the National Bank during those two years determined that the conditions for applying a lower risk weight i.e. conversion factor are fulfilled.

43. The product between the amount of claim allocated in a certain exposure category and the corresponding risk weight provides the weighted value of claim included in the determination of credit risk weighted assets.

Credit risk weighted assets shall be a sum of weighted value of all on-balance sheet and off-balance sheet claims determined under this Decision.

Capital requirement for credit risk is a product of the multiplication of credit risk weighted asset by 8%.

44. Any bank which is not required to determine capital requirement for market risk shall also include, in the amount of credit risk weighted assets, the credit risk arising from trading book positions by applying the corresponding risk weights and conversion factors.

VI.1 Determining risk weights for certain exposure categories

VI.1.1 Claims on central governments and central banks

45. A bank shall apply risk weights presented in table 1 or table 2 to claims on central governments and central banks, depending on whether they use long-term credit rating of recognized ECAI or credit rating of recognized ECA:

Table 1

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

Table 2

Credit quality level - ECA	0	1	2	3	4	5	6	7
Risk weight	0%	0%	20%	50%	100%	100%	100%	150%

46. A bank shall apply 100% risk weight to claims on central governments and central banks which has not been assigned any long-term credit rating by a recognized ECAI, i.e. credit rating by recognized ECA.

47. By way of derogation from items 45 and 46 of this Decision, 0% risk weight shall apply to claims on the central government of the Republic of Macedonia and on claims on the National Bank.

48. By way of derogation from items 45 and 46 of this Decision, 0% risk weight shall apply to claims on the European Central Bank.

VI.1.2 Claims on local and regional government

49. A bank shall apply the following risk weights (Table 3) to claims on local and regional government with a long-term credit rating of recognized ECAI:

Table 3

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

A bank shall apply the following risk weights to claims on local or regional government without long-term credit rating of a recognized ECAI:

- 100% if, under section VI.1.1 of this Decision, risk weight of 0%, 20%, 50% or 100% has been applied to claims on central government of the debtor's domicile country; or
- 150% if, under section VI.1.1 of this Decision, risk weight of 150% has been applied to claims on central government of the debtor's domicile country.

VI.1.3 Claims on public sector entities

50. A bank shall apply the following risk weights (Table 4) to claims on public sector entities with a long-term credit rating of recognized ECAI:

Table 4

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

A bank shall apply the following risk weights to claims on public sector entities without long-term credit rating of a recognized ECAI:

- 100% if, under section VI.1.1 of this Decision, risk weight of 0%, 20%, 50% or 100% has been applied to claims on central government of the debtor's domicile country; or
- 150% if, under section VI.1.1 of this Decision, risk weight of 150% has been applied to claims on central government of the debtor's domicile country.

51. By way of derogation from item 50 of this Decision, a bank shall apply risk weight under section VI.1.1 of this Decision to claims on public sector entities enjoying a treatment of central government, that apply to claims on central governments of the public institution's domicile countries.

A bank shall apply risk weights of item 50 of this Decision to claims on all other public sector entities in the Republic of North Macedonia.

52. Risk weights referred to in item 50 of this Decision shall apply to claims on public sector entities from EU member states which are not enjoying a treatment of central government granted by the competent authority of the country.

53. Public sector entities of third countries may not have a status of central government. The status referred to in item 50 of this Decision shall apply to claims on these public sector entities only if:

- Such status has been assigned by the competent authority of a third country, and
- The methodology for determining banks' capital adequacy is identical to the methodology defined by the EU member states.

54. Claims on all other public sector entities not included in items 50, 51, 52 and 53 of this Decision shall be included in the category of claims on other trade companies, i.e. are regulated by provisions of section VI.1.6 of this Decision.

VI.1.4 Claims on multilateral development banks and claims on international organizations

55. A bank shall apply the following risk weights (Table 5) to claims on multilateral development banks with long-term credit rating of a recognized ECAI:

Table 5

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

A bank shall apply the following risk weights to claims on multilateral development banks without credit rating of a recognized ECAI:

- 50% if, under section VI.1.1 of this Decision, risk weight of 0%, 20%, or 50% has been applied to claims on central government of the debtor's domicile country;

- 100% if, under section VI.1.1 of this Decision, risk weight of 100% has been applied to claims on central government of the debtor's domicile country; or
- 150% if, under section VI.1.1 of this Decision, risk weight of 150% has been applied to claims on central government of the debtor's domicile country.

56. By way of derogation from item 55 of this Decision, a bank shall apply the 0% risk weight to claims on the following multilateral development banks:

- 1) International Bank for Reconstruction and Development (IBRD),
- 2) International Finance Corporation (IFC),
- 3) Inter-American Development Bank,
- 4) Asian Development Bank,
- 5) African Development Bank,
- 6) Council of Europe Development Bank,
- 7) Nordic Investment Bank,
- 8) Caribbean Development Bank,
- 9) European Bank for Reconstruction and Development (EBRD),
- 10) European Investment Bank (EIB),
- 11) European Investment Fund,
- 12) Multilateral Investment Guarantee Agency (MIGA),
- 13) International Finance Facility for Immunization,
- 14) Islamic Development Bank.

By way of derogation from paragraph 1 of this item, a bank shall apply 20% risk weight to the portion of unpaid capital subscribed to the European Investment Fund.

57. A bank shall apply 0% risk weight to claims on international organizations.

VI.1.5 Claims on banks

58. A bank shall apply the following risk weights (Table 6) to claims on banks with long-term credit rating of a recognized ECAI:

Table 6

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

A bank shall apply the following risk weights to claims on banks without long-term credit rating of a recognized ECAI:

- 50% if, under section VI.1.1 of this Decision, risk weight of 0%, 20%, or 50% has been applied to claims on central government of the debtor's domicile country;

- 100% if, under section VI.1.1 of this Decision, risk weight of 100% has been applied to claims on central government of the debtor's domicile country; or
- 150% if, under section VI.1.1 of this Decision, risk weight of 150% has been applied to claims on central government of the debtor's domicile country.

59. By way of derogation from item 58 of this Decision, a bank shall apply the following risk weights (Table 7) to claims with residual maturity of up to 3 months on banks with long-term credit rating of a recognized ECAI:

Table 7

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

A bank shall apply the following risk weights to claims with residual maturity of up to 3 months on banks without long-term credit rating of a recognized ECAI (without long-term credit rating for the bank or for other financial instruments issued by such bank):

- 20% if, under section VI.1.1 of this Decision, risk weight of 0% or 20% has been applied to claims on central government of the debtor's domicile country;
- 50% if, under section VI.1.1 of this Decision, risk weight of 50% has been applied to claims on central government of the debtor's domicile country;
- 100% if, under section VI.1.1 of this Decision, risk weight of 100% has been applied to claims on central government of the debtor's domicile country; or
- 150% if, under section VI.1.1 of this Decision, risk weight of 150% has been applied to claims on central government of the debtor's domicile country.

60. By way of derogation of items 58 and 59 of this Decision, a bank shall apply risk weights specified by item 183 of this Decision to claims specified under item 183 of this Decision.

61. A bank shall apply risk weight of 100% to bank's investments in capital or own funds of other banks, except for investments which are a deduction from bank's own funds.

62. For the purposes of this section, bank shall denote banks and savings houses incorporated in the Republic of Macedonia (except for the Development Bank of North Macedonia), banks from the EU member states and foreign banks as defined by the Banking Law.

VI.1.6 Claims on other trade companies

63. In this category, a bank shall include claims on other trade companies, including claims based on stakes in closed investment funds, which are not elsewhere classified in section VI.1 of this Decision.

64. A bank shall apply the following risk weights (Table 8) to claims on other trade companies with long-term credit rating of a recognized ECAI:

Table 8

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

A bank shall apply the following risk weights to claims on other trade companies without long-term credit rating of a recognized ECAI:

- 100% if, under section VI.1.1 of this Decision, risk weight of 0%, 20%, 50% or 100% has been applied to claims on central government of the debtor's domicile country; or
- 150% if, under section VI.1.1 of this Decision, risk weight of 150% has been applied to claims on central government of the debtor's domicile country.

65. By way of derogation from item 64 of this Decision, a bank shall apply risk weight specified by item 183 to claims referred to in item 183 of this Decision.

VI.1.7 Retail portfolio

66. A bank shall apply risk weight of 75% on claims which, according to this section, are eligible to be included in the retail portfolio.

A bank shall apply risk weight of 100% to claims on natural persons who, according to this section, are not eligible to be included in the retail portfolio.

A bank shall apply risk weight referred to in section VI.1.6 of this Decision to claims on SC which according to this section are not eligible to be included in the retail portfolio.

By way of derogation from paragraphs 1 and 2 of this item, the bank is obliged to apply 150% risk weight to claims based on consumer loans with a maturity date equal to or longer than eight years.

The bank shall apply the provisions of paragraph 4 of this item to consumer loans with contractual maturity equal to or longer than eight years approved after 1 January 2016, including the consumer loans in which the bank has extended the maturity date after 1 January 2016, whereby the total maturity of the loan, determined as a sum of the contractual maturity on 1 January 2016 and of all extensions of the maturity date of the loan, is equal to or longer than eight years.

The determining of the total maturity date referred to in paragraph 5 of this item shall not take into account the extension of the maturity date of consumer loans performed in the period from 25 March to 30 September 2020, in accordance with item 58-b of the Decision on the methodology for credit risk management (Official Gazette of the Republic of Macedonia No. 149/18 and Official Gazette of the Republic of North Macedonia No. 76/20 and 116/20).

66-a. The bank is obliged to apply 75% risk weight to the positive difference between:

- total exposure on the basis of overdrafts and credit cards issued on the date of reporting and
- total exposure on the basis of overdrafts and credit cards issued on December 31, 2015.

For the purposes of paragraph 1 of this item, total exposure on the basis of overdrafts and issued credit cards is determined as the sum of the on-balance sheet and off-balance sheet claims on the basis of overdrafts and issued credit cards, without taking into account the conversion factors and credit risk mitigation instruments.

67. Certain claim may be included in the category of retail portfolio, if the following criteria are met:

- The debtor is either a natural person or an SC;
- Total exposure of the bank, its parent entity and its subsidiaries to the debtor and entities connected thereto does not exceed Denar 6,000,000, and takes into account only the on-balance sheet exposure. The calculation of total exposure does not include exposure covered by residential property and commercial real estate which meet the criteria referred to in sections VI.1.8 and VI.1.9 of this Decision;
- The exposure is not an investment in securities; and
- The exposure is a part of a group of exposures with similar features (retail portfolios), which makes the portfolio sufficiently diversified, as defined by item 68 of this Decision.

If the exposure specified by paragraph 1 indent 2 of this item does not exceed Denar 6,000,000, the bank may also include off-balance sheet exposure to the debtor and entities connected thereto in the retail portfolio.

The bank shall undertake certain activities to obtain information and data necessary for determining the total exposure to the debtor.

68. Retail portfolio shall be considered sufficiently diversified if:

- The bank has defined, in its internal policies and procedures, retail portfolios composed of same credit products and
- Bank's exposure (on-balance sheet and off-balance sheet) to the debtor and entities connected thereto, which meet the requirements under item 67 paragraph 1 indents 1, 2 and 3 of this Decision, shall be equal or lower than 0.2% of the total amount of retail portfolio.

Identical credit products shall be considered products with similar level of credit risk, taking into account features of the debtor, the product purpose or other similar features (such as same credit products: credit cards, consumer loans, car loans, student loans etc.).

69. For the purpose of this item and items 67 and 68 of this Decision, total exposure shall be the difference between the accounting value and the corresponding amount of premium or discount and the effects of change in fair value, not taking into account the amount of impairment i.e. special reserve and the amount of accumulated depreciation.

The calculation of total exposure to debtor and entities related thereto and of the total amount of retail portfolio shall not take into account the instruments for decreasing of credit risk under section VI.2 of this Decision and the conversion factors referred to in item 38 of this Decision.

VI.1.8 Claims secured by residential property

70. The bank shall apply 35% risk weight on claims collateralized by mortgage on a residential property, if the claim collateralized by mortgage on a residential property meets the criteria referred to in item 71 paragraph 1 of this Decision.

The bank shall distribute all other claims backed by mortgage on a residential property which do not meet criteria under item 71 of this Decision in the corresponding exposure category or shall include them in the retail portfolio if the requirements under section VI.1.7 of this Decision have been met.

71. Risk weight of 35% shall apply to claims that meet the following criteria:
- Mortgage on residential property in which a debtor has either resided or will reside or which the debtor, as owner of the building, has rented for residential purposes, on the basis of rent agreement;
 - The value of residential property does not depend significantly on the debtor's creditworthiness, not taking into account the potential influence of macroeconomic factors on the value of residential property and on the debtor's creditworthiness (e.g. debtor is both an investing entity or a contractor for construction works related to the construction of the residential property, where the debtor has a substantial share of the respective market);
 - The possibility for claim collection (debtor's credit risk) does not depend significantly on the cash inflows arising from the use of residential property, but rather on the debtor's capability to settle liabilities from other regular sources of funding;
 - The bank shall be obliged to provide an assessment of the current market value of the residential property in accordance with paragraphs 2 and 3 of this item;
 - The bank holds duly documentation for the pledged residential property that consists of notary act with annexes on mortgage on the property, including an executive clause, property deed or other evidence from a public book for established pledge issued by a competent institution, valid insurance policy on the residential property restrictively endorsed for the benefit of the bank and other similar documentation; and
 - Total amount of claim, without being reduced for the amount of impairment i.e. special reserve and without being haircut for the conversion factors and credit risk mitigation instruments, does not exceed 75% of the market value of the residential property, as defined under indent 4 of this item.

In the entire period of duration of the contract on the basis of which the claim occurred, collateralized by mortgage on a residential property, the bank shall be obliged to monitor the market value of the residential property (e.g. by applying statistical methods), at least once a year and to provide an assessment of the current market value of the residential property, at least once every three years, in accordance with the law.

As an exception to paragraph 2 of this item, the bank shall be obliged to provide an assessment of the current market value of the residential property at least once a year, for a claim that:

- exceeds 5% of the bank's own funds;
- is collateralized by mortgage on a residential property that witnessed a significant decrease in the market prices of similar residential properties, or
- is collateralized by mortgage on an unbuilt residential property for which a construction license has been issued by a competent institution, including the construction land for which a construction license has been issued by a competent institution, whereby the assessment of the market value should reflect the current value of the collateral, in accordance with the construction phase of the residential property.

VI.1.9 Claims secured by commercial real estate

72. A bank shall apply risk weight of 100% on claims secured by mortgage on a commercial real estate.

By way of derogation from paragraph 1 of this item, the bank may apply 75% risk weight to claim covered by commercial real estate if:

- commercial real estate is used for performance of the activity of the debtor;
 - the business property is owned by the debtor/co-borrower;
 - value of the commercial real estate does not depend significantly on the creditworthiness of the debtor, not taking into consideration the impact which macroeconomic factors might have on the value of the commercial real estate and on the creditworthiness of the debtor;
 - total amount of the claim, without reducing the amount of impairment, i.e. special reserve and without applying the conversion factors and credit risk mitigation instruments, does not exceed 50% of the market value of the commercial real estate;
- the criteria of item 71 indents 4 and 5 of this Decision are adequately fulfilled

VI.1.10 Nonperforming claims

73. The bank shall apply the following risk weights to the unsecured part of nonperforming claims:

- 150%, if the impairment is below 20% of the unsecured part of the claim, or
- 100%, if the impairment is at least 20% of the unsecured part of the claim.

74. By way of derogation from items 70 and 73 of this Decision, a bank shall apply risk weight of 100% to nonperforming loans that meet the criteria under item 71 of this Decision.

75. A bank may exclude the claim under the category of nonperforming claims when, according to the Decision on credit risk management, the claim no longer enjoys a status of nonperforming claim.

VI.1.11 High risk claims

76. A bank shall apply 150% risk weight to high risk claims, regardless of whether it is a nonperforming claim or other type of claim which, according to other parts of section VI.1 of this Decision, is allowed to be assigned a lower risk weight.

77. A bank shall identify claims with a status of high risk claims in its internal acts, taking into account the provisions of this Decision.

VI.1.12 Exposures in the form of stakes in investment funds

78. A bank shall apply risk weights presented in the table below (Table 9) to exposures in the form of stakes in investment funds with credit rating assigned by a recognized ECAI:

Table 9

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

Stakes in open investment funds shall be regarded as exposures in the form of stakes in investment funds.

79. A bank shall apply risk weight of 100% to exposures in the form of stakes in investment funds without a long-term credit rating being assigned by recognized ECAI.

A bank shall apply 150% risk weight to exposures in the form of stakes in private investment funds.

VI.1.13 Other positions

80. A bank shall apply risk weight of 100% to all other positions not classified in the previous exposure categories. This category shall, inter alia, include the following positions:

- Investments in the capital of other legal entities and other capital holdings (except for investments which are deductions from the Common Equity Tier

I capital, Additional Tier I capital and the supplementary capital of the bank). These investments are allocated to the category of the legal entity in question, and shall be assigned a risk weight of 100%;

- Claims on citizens' associations and foundations, churches, religious communities and groups and other nonprofit organizations;
- Fixed assets.

By way of derogation from paragraph 1 of this item, a bank shall apply 0% risk weight to cash, cash equivalents and gold, and 20% risk weight to cash items in process of collection.

By way of derogation from paragraph 1 of this item, a bank shall apply risk weight of the assets subject of the agreement, rather than the risk weight of the counterparty, to agreements on outright forward sale of assets and repo agreements.

VI.2 Credit risk mitigation instruments

81. When determining the weighted value of the claim included in the credit risk weighted assets, the bank may take into the consideration the influence of the credit risk mitigation instruments, pursuant to the terms and the method defined in Section VI.2 of this Decision.

82. The amount of claim's weighted value, obtained as a result of the effects of the credit risk mitigation instrument may not exceed the amount of the weighted value of the claim without taking into consideration the provisions of this Section.

Provided that the effects of the utilization of the credit risk mitigation instrument are already taken into account in the determining of the weighted value of the claim (for example, the instrument influences on the credit rating of the claim or the debtor), that instrument may not be used as a credit risk mitigation instrument.

In instances when the bank uses several credit risk mitigation instruments for one claim, the bank shall be required to divide the claim amount by the amount of the individual credit risk mitigation instruments and to determine the weighted value of the claim for each part.

83. The bank shall be required, within its policies and procedures for credit risk management, to specify the credit risk mitigation instruments it uses, the procedure and the activities for their acquiring, as well as the manner of managing the risks of application of those instruments (for example, legal, operational, market and liquidity risk and other similar risks).

84. The credit risk mitigation instruments can be funded or unfunded.

The funded credit risk mitigation instruments shall be those meeting the conditions under Section VI.2.1 of this Decision and that can be used in the determining of the credit risk weighted assets in the manner set forth in that part.

The unfunded credit risk mitigation instruments shall be used in the determining of the credit risk mitigation instruments according to the conditions and the manner set forth in Section VI.2.2 of this Decision.

85. When determining the weighted value of the claim, the bank shall be required to take into consideration the influence of the maturity mismatch resulting from the shorter residual maturity or validity period of the credit risk mitigation instrument than the residual maturity of the claim it refers to.

When determining the influence of the maturity mismatch, the following rules shall be taken into account:

- a) the residual maturity of the claim is equal to the shorter maturity of: (1) the longest residual maturity within which the debtor is required to fulfill its obligation completely, or (2) five years;
- b) the residual maturity of the credit risk mitigation instrument is equal to the nearest date on which the credit risk mitigation instrument can be used or can cease to exist, i.e. on which the issuer of the credit risk mitigation instrument may withdraw the issued instrument;
- c) provided that the credit risk mitigation instrument is divided in amounts maturing at different maturity dates, the bank shall be obliged to divide the instrument amount by different maturity dates and to determine adequately the amount of the weighted value of the claim for each part.

VI.2.1 Funded credit risk mitigation instruments

86. For the needs of this Decision, funded credit risk mitigation instrument shall be considered:

- financial collateral under Section VI.2.1.1 of this Decision;
- on balance sheet netting from Section VI.2.1.2 of this Decision, and
- other funded instruments from Section VI.2.1.3 of this Decision.

The funded credit risk mitigation instruments under paragraph 1 of this item can be used for the needs of determining of the credit risk weighted assets, if they meet all conditions defined in Section VI.2.1 of this Decision.

By way of derogation from item 85 of this Decision, the bank may not use the funded credit risk mitigation instrument in the determining of the weighted value of the claim, if its residual maturity is shorter than the residual maturity of the claim it refers to.

VI.2.1.1 Financial collateral

87. Financial collateral shall be considered the following funded credit risk mitigation instruments, only if meets the conditions from item 88 of this Decision:

- cash deposits or cash equivalents and gold with banks;
- debt instruments issued by the central Government of the Republic of Macedonia and the National Bank and by the central governments and the central banks being given a credit rating by recognized ECAI, or ECA equal to or better than 4, according to the credit quality level, pursuant to the rules under item 45 of this Decision (including also the instruments issued by the persons/entities under paragraph 2 of this item with a credit quality level equal to or better than 4);

- debt instruments issued by banks and other trade companies being given a long-term credit rating by recognized ECAI, which was determined to belong to the credit quality level equal to or better than 3, according to the rules from item 58 paragraph 1 and item 64 paragraph 1 of this Decision (including also instruments by the entities from paragraph 3 of this item with credit quality level equal to or better than 3);
- debt instruments issued by banks and other trade companies being given a short-term credit rating by recognized ECAI, which was determined to belong to the credit quality level equal to or better than 3, according to the rules from items 60, 65 and 183 of this Decision;
- debt instruments issued by banks with main offices outside the Republic of Macedonia, not been given credit rating by recognized ECAI, if fulfill the conditions under paragraph 4 of this item;
- debt instruments issued by domicile banks in the Republic of Macedonia listed on the Macedonian Stock Exchange AD Skopje;
- stakes in investment funds if the conditions from paragraph 5 of this item are met;
- shares or convertible bonds included in the main stock exchange index (the Macedonian stock exchange index - MBI10 is considered the main stock exchange index on the Macedonian Stock Exchange AD Skopje).

Debt instruments issued by the central governments or the central banks from paragraph 1 indent 2 of this item shall be considered the debt instruments issued by:

- the public sector entities enjoying a treatment of central government for which risk weight according to item 51 paragraph 1 of this Decision is applied;
- the multilateral development banks for which 0% risk weight is applied, according to item 56 of this Decision;
- international organizations for which 0% risk weight is applied, according to item 57 of this Decision.

Debt instruments under paragraph 1 indent 3 of this item shall be considered those issued by:

- the local and regional government, according to item 49 paragraph 1 of this Decision;
- the multilateral development banks according to item, 55 paragraph 1 of this Decision;
- public sector entities, according to item 50 paragraph 1 of this Decision.

The debt instruments issued by banks with min offices outside the Republic of Macedonia, not been given a credit rating by a recognized ECAI, can be considered financial collateral if the following conditions are met:

- the instruments are listed on the recognized stock exchange;
- all other financial instruments issued by that bank, having the same priority right for payment as the funded credit risk mitigation instrument, were given a credit rating by a recognized ECAI which was determined to belong to the credit quality level of at least 3, according to the rules under Section VI.1.5 of this Decision;
- the bank has information that can produce a conclusion that the funded credit risk mitigation instrument should be rated more favorably than the rating being determined to belong to the credit quality level of at least 3, and

- the banks is certain that the debt instrument can be easily sold on the market.

The stakes in the investment funds can be considered financial collateral only if the following conditions are met:

- the stake price is released on a daily basis, and
- the investment fund is limited to invest only in instruments that can be acknowledged as financial collateral, pursuant to the provisions of this item.

Provided that the debt instruments under paragraph 1 indents 2, 3 and 4 were given credit rating by two recognized ECAI, the banks shall apply the less favorable credit rating. Provided that these debt instruments were given credit ratings from three or more recognized ECAI, the bank shall be obliged to select the both most favorable credit ratings and to apply the less favorable of these two ratings.

88. The financial collateral from item 87 of this Decision should meet the following conditions:

- a) There is low correlation, i.e. no positive material connection (correlation) between the debtor's creditworthiness and the value of the financial collateral. Positive material connection exists when the collateral is issued by the debtor or the person/entity connected with the debtor. The securities issued by the debtor or the person/entity connected with the debtor can not be recognized as financial collateral;
- b) Existence of legal certainty:
 - according to the financial collateral agreement, the bank is entitled to collect or hold the collateral forthwith in instance of non-collection of the claim, insolvency or opening a bankruptcy procedure against the debtor or the person/entity custodian of the financial collateral, or in instance of the realization of some other agreed event;
 - the bank is required to meet all agreement and legal requirements and take all necessary activities in order to ensure enforcement of the financial collateral agreement without any limitations, according to the regulations pertaining to such agreements;
 - in the financial collateral agreements which include application of regulations of other country, the bank is required to obtain legal opinion from a lawyer from the country the regulations of which are applied, verifying the possibility for performing the agreement pursuant to the regulations of the other country. In addition, for the purpose of bank assurance that the financial collateral agreement can be performed without any limitations, it is obliged at least once a year during the agreement validity to obtain another legal opinion from a lawyer from the country the regulations of which are applied for the possibility for its execution;
- c) The operating requirements which refer to the bank's liabilities are met:
 - to have written agreement for the financial collateral and prescribed procedures for its timely activation,
 - to establish and apply adequate policies and procedures for controlling the risks arising from the use of the financial collateral. Apart from the risks from item 83 of this Decision, the control should cover also the inefficiency risks, or risk of lowering the financial collateral efficiency, its termination,

the risks arising from its evaluation, the risk of concentration of individual types of financial collateral etc.,

- to establish and implement the policies or procedures defining the acceptable types and amounts of the financial collateral,
- to determine regularly the market value of the financial collateral, meaning reconciliation of its value with the market value at least on a quarterly basis, or even more often, if significant change in the market prices occur, or if the secured claim exceeds 5% of the bank's own funds;
- in case the financial collateral is held by a third party - custodian, the instrument is not part of the assets of the custodian, but held on a special account.

89. The claims covered with the financial collateral meeting the criteria in this Section, the banks shall apply the risk weight which would be applied in instance of direct exposure to that collateral (risk weight of the collateral).

By exception to paragraph 1 of this item, the claims shall be covered with the following:

- financial collateral from item 87 paragraph 1 indent 6 and with equity instruments, which are part of MBI10, the bank applies risk weight of 50%;
- gold with the bank, the bank applies risk weight of 20%, and
- cash deposit with the bank, the bank applies risk weight of 0%.

When determining the level of covering the claim with the financial collateral and determining the weighted value of the claim, the bank shall be required to adhere to the following rules:

- the risk weight of the collateral to be applied only on the secured part of the claim. The unsecured part of the claim shall obtain a risk weight according to the risk category the claim belongs to;
- to take into consideration the amount of the market value of the financial collateral, determined according to item 88 sub-item c) indent 4 of this Decision;
- the lowest risk weight the bank applies for the claims covered with financial collateral can not be lower than 20%, except to instances from paragraph 2 of this item and items 90 and 91 of this Decision;
- in instance of currency mismatch between the claim and financial collateral, the market value of the financial collateral to be corrected by applying the following formula:

$$G^* = G \times (1 - 0,08), \text{ where:}$$

G shall denote the market value of the financial collateral

G* shall denote the haircuts of financial collateral taken into consideration in the determining of the amount of the secured part of the claim.

90. The claim covered with financial collateral that occurred on the basis of repo agreement or loan agreement or borrowing securities, the bank may obtain a risk weight of 0%, if the following conditions are met:

- the claim and the financial collateral are cash deposit, cash funds or cash equivalents or debt instruments issued by central governments or central banks, which pursuant of Section VI.1.1 of this Decision, risk weight of 0% shall be applied;

- the claim and the financial collateral are presented in same currency;
- the agreement due date is maximum one day (for example, overnight repo agreements) or daily market reconciliation of the claim value and the value of the financial collateral is performed, or daily remargining is performed);
- the period between the date of the last reconciliation with the market price when the debtor failed to perform its obligation for payment of the remargining and the date of the collateral execution, should not exceed four days;
- the settlement is performed through the settlement system which is regularly used for such positions;
- the agreement is concluded on the basis of standard documentation used for such positions;
- according to the agreement, the counterparts are entitled to terminate or cancel the agreement, in event of default of the other counterparty;
- the other counterparty is basic market participant. The following entities shall be deemed core market participants:
 - a) central governments or the central banks, for which risk weight of 0% are applied;
 - b) the banks;
 - c) other financial institutions, including also the insurance companies, for which risk weight of maximum 20% are applied;
 - d) authorized clearing houses.

Provided that the repo-agreements or the loan agreements or borrowing of securities covered with financial collateral meet all the conditions from paragraph 1 of this item, except the condition that binds the other counterpart to be the main market participant, the bank can apply risk weight of 10% on those positions.

91. The bank can apply risk weight of 0% on the positions in the financial derivatives traded on the over the counter covered with financial collateral, if:

- their market value is presented on a daily basis;
- they are covered with cash deposit, cash funds or cash equivalents, and
- there is no currency mismatch between the financial derivative and the financial collateral.

On the positions in the financial derivatives traded over the counter and which meet the conditions from paragraph 1 indents 1 and 3, and covered with debt instruments issued by central government or central bank for which risk weight of 0% is applied, the bank can apply risk weight of 10%.

The bank can apply risk weight of 0% on the positions from paragraph 2 of this item, only if the correlation between the position in the financial derivative and the market value of the debt instrument equals at least 1:1,20.

For meeting the needs under paragraphs 2 and 3 of this item, central government or central bank shall be considered also the multilateral development banks and international organizations to which risk weight of 0% is applied.

VI.2.1.2 On-balance sheet netting

92. The bank may recognize an on-balance sheet netting of the mutual claims and liabilities with the debtor as funded credit mitigation instrument if the following conditions are met:

- netting of the credits and deposits with the banks;
- the agreement on the on-balance sheet netting can be implemented in all instances without any limitations, including also the instances such as insolvency, bankruptcy or liquidation of the debtor;
- the bank can determine the monetary claims and liabilities subject to the agreement on netting;
- the bank performs regular monitoring and control over the risks that can arise from the termination of the validity of the agreement on the on-balance sheet netting;
- for the on-balance sheet netting agreements including implementation of regulations of other country, the banks shall be required to obtain legal opinion from a lawyer from the country the regulations of which are applied, verifying the possibility for execution of the agreement according to the regulations of the other country. Besides, in order to ensure the bank that the agreement can be performed without any limitations, it shall be required, once a year during the validity of the agreement, to obtain another legal opinion from the country the regulations of which are applied for the possibilities for its execution, and
- the bank conducts regular monitoring and control on the exposure on net basis.

93. Provided that the agreement for the on-balance sheet netting meets the conditions of this Section of the Decision, the bank may, in the determining of the credit risk weighted assets, include the difference between the credits and deposits which are subject to the agreement (net amount). The weighted value of the claim shall be obtained as a product of the net amount and the risk weight applied for the credit, i.e. debtor. The net amount shall be included in the determining of the credit risk weighted assets only if the difference between the credits and deposits is positive. If the difference is equal to zero or negative, the net amount shall not be included in the credit risk weighted assets.

In case of currency mismatch between the credits and deposits subject to netting, the value of the deposit shall be haircut according to the following formula:

$$C^* = C \times (1 - 0,08), \text{ where:}$$

C shall denote the deposit value

C* shall denote the haircut deposit value which is taken into consideration in the determining of the net amount.

VI.2.1.3 Other funded instruments

94. Other funded instruments shall be considered those meeting the criteria of this Section of the Decision:

- cash deposits or cash equivalents with third party which is not one of the counterparts of the agreement, or
- life insurance policies.

95. Cash deposits or cash equivalents from item 94 indent 1 of this Decision should meet the following conditions:

- the pledge agreement or agreement for transfer of cash deposit/cash equivalent of the bank is prepared on the basis of a law and the bank is entitled to collect or acquire the cash deposit/cash equivalent forthwith in instance of claim uncollectibility, insolvency or instigating a bankruptcy procedure against the debtor or against the entity holding the cash deposit/cash equivalent, or in case of realization of other agreed event;
- the third party must be notified on the pledge or the transfer right;
- on the basis of the notification under indent 2 of this item, the third party may make payment of the cash deposit/cash equivalent only to the bank or to other party, after prior consent from the bank being obtained; and
- the pledge or the transfer goes in favor of the bank and is unconditional and irrevocable.

96. The life insurance policy under item 94 indent 2 of this Decision should meet the following conditions:

- the life insurance policy is pledged with a bank restrictively endorsed for the benefit of the bank;
- the insurance company that issued the policy has been informed on the pledge and should not make payment on the basis of the policy, without prior approval from the bank;
- in case of claim uncollectibility the bank is entitled to cancel the life insurance policy and to collect the redemption value of the policy, having no legal provisions limiting the collection of the purchasing value;
- the bank must be informed on each late liability payment by the debtor on the basis of the life insurance policy;
- by exception to item 86 paragraph 3 of this Decision, if the maturity date of the policy is shorter than the residual maturity of the claim, the policy can be used as a credit risk mitigation instrument only if the bank provides conditions for replacement of the amount received from the policy payment with another credit risk mitigation instrument until the expiration of the maturity date of the claim, pursuant to the provisions of this Decision;
- the pledge or the restrictive endorsement should have power of enforcement document pursuant to the law;
- the redemption value of the policy is published by the insurance company that issued also this value and it may not be reduced;
- the bank should be able to make timely payment of the redemption value of the policy, i.e. the payment of the policy to be performed in reasonable period;
- the insurance company must not pay the redemption value of the policy, without prior approval of the bank;
- the insurance company is an insurance company or a subsidiary of a foreign insurance company being licensed for performing insurance activities by Insurance Supervision Agency or insurance company from a EU member state or it is a company with the main office located outside the Republic of Macedonia which is subjected to the regulations and insurance supervision at least equal to the regulations and the supervision of the European Union member states.

97. Weighted value of the claim secured with cash deposit/cash equivalent from item 95 of this Decision, shall be determined as a product of the amount of the cash deposit/cash equivalent and the risk weight that would be applied in case of direct exposure to the person that holds that deposit/equivalent (risk weight of third party).

In case of currency mismatch of the claim and the cash deposit/cash equivalent, the value of the cash deposit/cash equivalent shall be haircut by using the following formula:

$G^* = G \times (1 - 0,08)$, where:

G shall denote the value of the cash deposit/cash equivalent which meets the conditions under this Decision;

G* shall represent the haircut amount of the cash deposit/cash equivalent taken into consideration in the determining of the weighted value of the claim.

98. The weighted value of the claim secured with life insurance policy from item 96 of this Decision shall be determined as a product of:

- the redemption value of the life insurance policy and
- risk weight, which pursuant to this Decision, is applied to the insurance company that issued the policy.

Provided that the insurance company is not been given a long-term credit rating determined by recognized ECAI, the weighted value of the claim shall be determined by using a risk weight of 70%.

In case of currency mismatch of the claim and the life insurance policy, the bank shall be obliged to correct the redemption value of the life insurance policy by applying the following formula:

$G^* = G \times (1 - 0,08)$, where:

G shall denote the amount of the redemption value of the life insurance policy;

G* shall denote the haircut amount of the redemption value of the life insurance policy which is included in the determining of the weighted value of the claim.

99. In instances when the claim is not fully covered with other funded credit risk mitigation instrument, the bank may apply the procedure stipulated in this Section of this Decision to the secured part, if the secured and unsecured part of the claim have equal collection order from the client (the bank and the provider of the instrument share the losses proportionally).

In the instances from paragraph 1 of this item the total amount of the weighted value of the claim shall be obtained by applying the following formula:

$$(E - G^*) \times r + G^* \times g$$

E shall denote the amount of the claim determined pursuant to item 35 of this Decision. If it is an off-balance sheet claim, that claim shall be fully included in the formula for determining of the total weighted amount, i.e. conversion factor of 100% is applied;

G* shall denote the value of the other funded instrument for credit risk mitigation determined according to this Section of the Decision;
r shall denote the risk weight which according to this Decision is applied in the exposure category to which the claim secured with other funded credit risk mitigation instrument belongs to;
g shall denote the risk weight which according to this Decision is applied to third party/issuer of the instrument.

VI.2.2 Unfunded credit risk mitigation instruments

100. Unfunded credit risk mitigation instrument shall refer to guarantees and counter guarantees.

The bank may recognize only the unfunded credit risk mitigation instruments which meet the criteria from items 101 and 102 of this Decision.

101. The guarantees and counter guarantees should fulfill the following criteria:

- 1) clear defining of the instrument scope (there is clear connection between the instrument and the bank's claim that instrument refers to);
- 2) the guarantee/counter guarantee should be issued by:
 - a) central government or central bank, including also the public sector entities enjoying a treatment of central government, and the entities under item 39 paragraph 2 of this Decision,
 - b) multilateral development bank,
 - c) international organization,
 - d) bank,
 - e) other trade company, including also the parent entity, the subsidiaries or the entities/persons having a share in the bank, if they have a credit rating from recognized ECAI, being determined that it belongs to the credit quality level equal to or better than 2;
- 3) the agreement for guarantee or counter guarantee fails to include provisions the execution of which is not within the bank control and which
 - empowers the issuer of the guarantee/counter guarantee to cancel the agreement unilaterally,
 - enables increase in the cost for using credit risk mitigation in case of worsening of the credit quality of the claim or the debtor,
 - limits the issuer of the guarantee/counter guarantee to make timely payment in case the debtor fails to settle its liabilities on the basis of any due claim,
 - empowers the issuer of the guarantee/counter guarantee to cut the maturity date of the credit risk mitigation instrument; and
- 4) the guarantee or the counter guarantee is concluded such to enable their execution pursuant to the adequate regulations.

Apart from the criteria under paragraph 1 of this item, the guarantees can be used as unfunded credit risk mitigation instrument, if meet the following criteria:

- the guarantee is direct claim from the issuing entity,
- in instance of non-settlement of the liabilities by the debtor, the bank shall be entitled to require from the guarantee issuer to pay back the due amount within reasonable period. The payment that the issuer of the

- guarantee should make must not be conditioned with a obligation for the bank to request previously a collection of the due claim by the debtor;
- provided that the guarantee collateralize a housing loan, the fulfillment of the criterion under paragraph 1 sub-item 3) indent 3 is limited to 36 months. It means that in case of debtor default, the bank can collect its claim through foreclosure and sale of the residential property. In case it fails to sell the housing facility within 36 months, the bank shall be obliged to foreclose and request payment of the due claim by the guarantee issuer;
- the guarantee is based on a liability that the guarantee issuer has assumed in written or other adequate form which can serve as a proof for the guarantee issuance; and
- the guarantee covers all the payments arising from the claim it refers to. Contrary, the amount that is included in the determining of the credit risk weighted assets should be reduced adequately for the part of the claim that is not covered by the guarantee.

Beside the criteria from paragraph 1 of this item, the counter guarantees can be used as unfunded credit risk mitigation instrument, if meeting the following additional criteria:

- the counter guarantee covered all elements of the credit risk which arises from the claim it refers to;
- the counter guarantee and the guarantee the counter guarantee refers to meets the criteria from paragraph 2 of this item, except that the counter guarantee is not required to meet the criterion from paragraph 2 indent 1;
- the bank has no information that will produce a conclusion that the amount covered by the counter guarantee is smaller than the amount covered by the guarantee it refers to;
- the bank can recognize also the counter guarantees issued by other entities as unfunded credit risk mitigation instruments, except the entities from paragraph 1 sub-item 2) of this item, if those counter guarantees are covered by guarantee from entities from paragraph 1 sub-item 2) of this item and if all other conditions from this item are met.

102. Beside the fulfillment of the conditions under item 101 of this Decision, the bank shall be obliged to include the utilization of the unfunded credit risk mitigation instruments in the process of management of all risks and to establish a system of concentration risk management, which arises from the use of these instruments.

By exception to item 85 of this Decision, the bank may not use the guarantee/counter guarantee in the determining of the claim's weighted value, in the following instances:

- The residual maturity date of the guarantee/counter guarantee is shorter than three months than the residual maturity date of the claim it refers to; or
- The agreed maturity date of the guarantee/counter guarantee is shorter than one year as well as from the residual maturity date of the claim it refers to.

103. The weighted value of the claim collateralized with unfunded credit risk mitigation instrument shall be determined as a product of the instrument amount (guarantee/counter guarantee) and the risk weight, which pursuant to this Decision, is applied to the issuer of the instrument.

In case of currency mismatch between the claim and the unfunded credit risk mitigation instrument, the value of the unfunded credit risk mitigation instrument shall be corrected by applying the following formula:

$$G^* = G \times (1 - 0,08), \text{ where:}$$

G shall denote the value of the unfunded credit risk mitigation instrument;
G* shall denote the unfunded credit risk mitigation instrument that is taken into consideration when determining the weighted value of the claim.

In case of maturity mismatch of the unfunded credit risk mitigation instrument and the claim, which is allowed according to this Section, the instrument value shall additionally be corrected according to this formula:

$$G_a = G^* \times (t-t^*)/(T-t^*)$$

G_a shall denote the value of the unfunded credit risk mitigation instrument that is taken into consideration in the determining of the claim's weighted value;

G* shall denote the amount of the unfunded credit risk mitigation instrument corrected by the amount of the currency mismatch (if there is no currency mismatch G* = G);

t shall denote the smaller amount of the parameter T value and the number of years until the maturity date of the unfunded credit risk mitigation instrument, determined pursuant to item 85 of this Decision;

T shall denote the number of years until the maturity date of the claim determined pursuant to item 85 of this Decision, with this number shall not exceed five years;

t* shall be equal to 0.25.

104. Provided that the claim has not been fully secured with unfunded credit risk mitigation instrument, the bank may apply the procedure set forth in item 103 of this Decision to the secured part of the claim, if the secured and unsecured part of the claim have equal payment order (the bank and the issuer of the instrument share the losses proportionally).

In the instances from paragraph 1 of this item, the total amount of the weighted value of the claim shall be obtained by applying the following formula:

$$(E - G_a) \times r + G_a \times g$$

E shall denote the total amount of the claim determined pursuant to item 35 of this Decision. In case of off-balance sheet claim, that particular claim shall be fully included in the formula for determining the total weighted amount, i.e. a conversion factor of 100% shall be applied;

Ga shall denote the value of the unfunded credit risk mitigation instrument determined pursuant to item 103 of this Decision. Provided that there is no maturity mismatch between the claim and the unfunded credit risk mitigation instrument, $G_a = G^*$. Provided that there is no currency mismatch between the claim and the unfunded credit risk mitigation instrument, $G^* = G$. The difference between E and Ga shall give the amount of the unsecured part of the claim;
r shall denote the risk weight, which pursuant to this Decision is applied to the exposure category the claim belongs to;
g shall denote the risk weight which pursuant to this Decision is applied to the issuer of the instrument.

VII. CAPITAL REQUIREMENTS FOR CURRENCY RISK

105. 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%.

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

107. The bank's aggregate foreign currency position, determined according to items 108 and 109 of this Decision, shall include the bank's foreign currency asset and liability positions.

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

108. The net foreign currency position 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 positions 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,
- value of currency options presented as specified under item 173 of this Decision.

The positions from paragraph 1 indents 1 and 2 of this item which are classified in the risk categories C, D and E shall be presented on a net basis, i.e. reduced by the adequate amount of the impairment/special reserve. The off-balance sheet positions

from paragraph 1 indent 3 of this item shall be presented on net basis, i.e. they are reduced by the adequate amount of the special reserve.

The bank's currency positions originating from its operations on behalf of third parties and for the account of third parties, and the on-balance sheet positions which, as specified by Section III of this Decision represent deductions from the Common Equity Tier I capital, Additional Tier I capital and the supplementary capital, 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 National Bank valid on the date of calculating the net currency position for such currency.

109. 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 positions is lower than the sum of liability positions.

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

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 RISKS

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

- 1) Capital requirement for position risk, as a sum of:
 - capital requirements for risk of investments in debt instruments, as defined according to Section VIII.3 of this Decision, and
 - capital requirements for risk of investments in equity instruments, as defined according to Section VIII.4 of this Decision, and

2) Capital requirements for exceeding exposure limits, as defined according to Section VIII.5 of this Decision.

The capital set according to Section XI of this Decision, shall also be accordingly included in the amount of capital under paragraph 1, depending on the underlying option.

111. The capital requirements for position risk 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.

112. 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 bank may perform the netting as stated in paragraph 1 of this item, in the case of:

- long and short positions in the same financial instrument issued by one person;
- long and short positions in different financial instruments issued by one person, only if the financial instruments are of the same seniority or the financial instruments in which the bank has short position are junior to the instruments in which the bank has long position.

VIII.1 Treatment of financial derivatives and other financial instruments

113. When determining the capital requirements for market risks, the positions in the financial derivatives and other financial instruments shall be a combination of long or short position, presented in line with the provisions stipulated in this Section. 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 and equity instruments.

114. 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 present 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.

115. 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 foreign exchange forwards (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 deadline for performing the envisaged purchase i.e. sale of 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.

116. 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).

117. 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 futures). 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 equity instruments.

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 futures). 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 equity instruments.

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 instrument which are part of 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 present value of each stock exchange index component.

118. The interest rate swaps where the bank receives variable interest rate and pays fixed interest rate shall be presented as a combination of long position in debt instruments with variable 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 variable interest rate shall be presented as a combination of short position in debt instruments with variable 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/variable interest rate and short position in debt instrument in other currency with fixed/variable interest rate, taking into account the maturity of each exchanging currency. The positions of this type of swaps shall also be included in the determining of capital requirements for currency risk as positions in currencies exchanged according to their maturity.

119. The equity swaps 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 variable interest rate shall be presented as a combination of long position in debt instruments with fixed or variable 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 variable interest rate shall be presented as a combination of short position in debt instruments with fixed or variable 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.

120. The investments in stakes in investment funds (collective investment undertakings) 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.

121. 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.

122. The positions in securities (equity instruments, 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 instruments, 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.

123. 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 XI of this Decision and shall be adequately included in the capital requirements for market risks, commodity risk and currency risk.

VIII.2. Underwriting and/or placement of issue of securities

124. The positions originating from the bank's obligation for underwriting and/or placement of securities issue, shall be accordingly included in the calculation of the capital requirements for risk of investments in equity instruments or investments in debt instruments, according to Sections VIII.3 and VIII.4 of this Decision.

The inclusion of the positions under paragraph 1 of this item shall be performed as follows:

- determining the net position of the bank in securities the issue of which is underwritten, i.e. unconditionally bounded that accepts them at agreed

price. Net position shall be the difference between the amount of the securities issue underwritten by the bank and the amount of securities written or transferred to third parties that assumed an obligation to sub-underwrite the issue;

- the net position is reduced by the reduction factors from Table 10.

Table 10

	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.

VIII.3 Capital requirements for risk of investments in debt instruments

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

In the calculation from paragraph 1 of this item, the bank shall be obliged to include positions on the basis of underwriting and/or placement of debt instrument issue, as well as 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 item 112 and Section VIII.1 of this Decision and determine the capital requirements for risk of investments in debt instruments for each currency.

VIII.3.1. Specific risk

126. 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 variable interest rates).

127. The bank shall weigh the positions according to the weighs presented in Table 11 on the basis of the classification according to the residual maturity.

Table 11

Risk-free positions	Qualified positions	Other positions
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	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 by persons/entities, or provided by credit risk mitigation instruments which, according to Section VI of this Decision, have been assigned 0% credit risk weight.

Qualified positions shall be positions:

- issued, or guaranteed by central governments at which, according to Section VI of this Decision, risk weight of 20% or 50% is applied;
- issued by central banks, international organizations, multilateral development banks and local and regional government, which pursuant to Section VI of this Decision are distributed in the credit quality level of 2 or 3;
- issued or guaranteed by banks and other trade companies, which according to Section VI of this Decision are distributed in credit quality level of 1 or 2.

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

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

VIII.3.2. General risk

129. The bank shall calculate the general risk amount on the basis of the residual maturity of the positions in debt instruments and their interest rate. The application of weighs presented in Table 12 derives weighted long and short positions in each debt instrument.

Table 12

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

130. Prior to the presentation of the positions in financial derivatives, as defined in Section VIII.1 of this Decision, 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 variable 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 variable 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.

131. 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 132 of this Decision).

132. 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 133 of this Decision.

133. 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 mismatched 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.

134. 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.

VIII.4. Capital requirements for risk of investments in equity instruments

135. 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 instruments as a sum of the capital requirements for such risk for each national market.

Positions in equity instruments which are part of the trading portfolio shall be considered also the positions based on underwriting and/or placement of issue of equity instruments.

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

- the amount of specific risk determined according to item 137 of this Decision, multiplied by 4%,
- the amount of general risk determined according to item 138 of this Decision, multiplied by 8%.

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

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

VIII.5. Capital requirements for exceeding the exposure limits

139. Capital requirements for exceeding exposure limits shall be obtained by including those positions in debt instruments and equity instruments registering the highest specific risk as defined in Sections VIII.3 and VIII.4 of this Decision, the transactions in debt instruments, equity instruments, currencies and goods for which capital requirements for settlement/delivery risk are calculated, as defined by section VIII-a of this Decision and the financial instruments for which capital requirements for counterparty risk are calculated, as defined by section VIII-b of this Decision.

140. For each exceeding of the exposure limits prescribed in the Banking Law (3%, 10%, 25%, 65%, 800%), which occurred as a result of the exposure from item 139 of this Decision, the bank shall be obliged to determine the capital requirements for covering the exceeding of exposure limits.

The bank exposure to person/entity and its connected persons/entities, arising from the positions in the banking book, shall not exceed the exposure limits prescribed in the Banking Law.

141. Provided that the exceeding of the exposure limits last less than 10 days, the capital requirements for covering that excess shall be obtained by multiplying the excess amount by 200%.

Provided that the exposure limits last longer than 10 days and more, the bank shall be required to distribute the excess amount in column 1 of Table 13, according to its percentage share in the own funds. The capital requirements for covering the exceeding shall be obtained by multiplying the excess amount by the adequate weight given in Table 13.

Table 13

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

VIII-a .CAPITAL REQUIREMENTS FOR SETTLEMENT/DELIVERY RISK

142. The bank shall be required to determine the capital requirements for settlement/delivery risk for transactions with debt instruments, equity instruments, currencies and goods as follows:

- for all transactions that are not settled within five working days or more after the agreed settlement date, as specified in item 143 of this Decision, and
- for all transactions envisaging free delivery, as specified in item 144 of this Decision.

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

143. In instances when certain transaction is not settled within five working days or more after the agreed settlement date, the capital requirements for settlement/delivery risk shall be calculated as a product of the difference between the agreed settlement price for that position and its current market value and the adequate weight from column 2 of Table 14.

Table 14

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).

144. For the positions for which free delivery is envisaged, the capital requirement for settlement/delivery risk shall be determined in the following instances:

- if the debt instruments, equity instruments, the currencies and goods are paid before their delivery, or the delivery is performed before the payment;
- with the transactions with abroad, if one, or several days elapsed from the moment of the payment, i.e. delivery from indent 1 of this paragraph.

In the instances from paragraph 1 of this item, the capital requirements for settlement/delivery risk shall be determined according to Table 15.

Table 15

Number of working days after the payment date or delivery	Capital requirements amount
up to one working days	0

from one to four working days	The agreed amount of the performed payment/delivery is weighted as specified in Section VI of this Decision (credit risk)
after the fifth working day	The agreed amount of the payment/delivery performed, increased by the current positive exposure (if any) obtains treatment of a deductible item of the own funds

The current positive exposure shall be equal to the positive difference between the fair value of the payment/delivery performed and the fair value of the default delivery/payment, on the date of determining of the capital from paragraph 1 of this item.

VIII-b .CAPITAL REQUIREMENTS FOR COUNTERPARTY RISK

145. The capital requirements for counterparty risk shall be calculated for the following financial instruments:

- financial derivatives;
- repo agreements for sale/purchase of securities and goods and agreements for lending/borrowing securities and goods;
- margin lending transactions;
- transactions with long settlement deadline.

146. For the needs of determining the capital requirements for counterparty risk, the bank shall be required to determine the amount of the weighted exposure to counterparty risk as a product of:

- the exposure to counterparty risk for all positions from item 145 paragraph 1 of this Decision, determined according to items 147 and 149 or 150 of this Decision and
- the risk weight for the counterparty, as specified in Section VI of this Decision.

147. The bank shall determine the exposure to counterparty risk for each position from item 145 paragraph 1 of this Decision by applying the original exposure method or market value method, as specified in items 149 and 150 of this Decision. The bank shall be obliged to apply the same method for all positions belonging to the same group from item 145 paragraph 1 of this Decision.

By exception to paragraph 1 of this item, only the bank applying the original exposure method for determining the exposure to counterparty risk for certain group position can switch towards use of the market value method.

By exception to paragraph 1 of this item, the bank shall be required to apply the market value method for determining the exposure to counterparty risk for positions from item 145 paragraph 1 of this Decision which refer to the equity instruments, precious metals or goods.

148. The capital requirements for counterparty risk shall be obtained by multiplying the weighted exposure to counterparty risk from item 147 of this Decision by 8%.

149. When applying the original exposure method, the exposure to counterparty risk from individual position (agreement) shall represent notional value of the position and the adequate percentage from Table 16.

Table 16

Contractual maturity	Agreements referring to interest rates	Agreements referring to foreign exchange rates and gold
To 1 year	0.5%	2%
1-2 years	1.0%	5%
For each additional year	+ 1.0%	+ 3%

150. According to the market value method, the exposure to the counterparty risk from individual position (agreement) shall be the sum of:

- **the current exposure** determined as a cost for position replacement. The replacement cost denotes the market value of the position, i.e. the amount to be paid by the bank in case of a need of position replacement. If this amount is negative, then the cost is equal to zero;
- **the potential exposure to counterparty risk** obtained as a product of the notional value of the position and the adequate percentage from Table 17.

Table 17

Residual maturity	Agreements referring to interest rates	Agreements referring to foreign exchange rate and gold	Agreements referring to equity instruments	Agreements referring to precious metals, except gold	Agreements referring to goods that are not precious metal
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%

The agreements that can not be arranged in any of the categories from Table 17, the bank shall be obliged to apply the adequate percentage for the agreements referring to the goods that are not precious metal.

For the agreements for which it is envisaged payment of principle in several occasions, the bank shall be obliged to multiply the percentages in Table 17 by the number of residual payments of the principle, according to the provisions of the agreement.

IX. CAPITAL REQUIREMENTS FOR COMMODITY RISK

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

152. 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.

153. 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 154 and 155 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.

154. The positions in financial derivatives and other financial instruments that relate to commodities shall be presented as combination of long and short position with adequate 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.

155. 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.

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

- 15% of the net position of the commodity determined according to item 157 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 158 of this Decision, multiplied by the current market price of such commodity.

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

158. 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.

159. The total bank's capital requirements for commodity risk shall be equal to the sum of the bank's capital requirements for commodity risk for each commodity traded by the bank.

X. CAPITAL REQUIREMENTS FOR OPERATIONAL RISK

160. The bank shall determine the capital requirements for operational risk by applying the basic indicator. The basic indicator shall represent a sum of the following positive and negative positions, realized as a result of the bank's regular operation:

- 1) Interest income;
- 2) Interest expenses;
- 3) Dividend income, except income arising from investment in affiliates, subsidiaries and joint ventures;
- 4) Income from commissions and fees;
- 5) Expenses from commissions and fees;
- 6) Income and expenses from positions that are part of the trading book;
- 7) Income and expenses from exchange rate differences;
- 8) Realized income and expenses from positions which are not measured at fair value through the Income Statement, if they arise from positions which are part of the trading book;
- 9) Income and expenses from hedging positions;
- 10) Other operating income.

Other operating income shall not include the extraordinary income and the income from concluded insurance contracts on the behalf and for the account of the bank. The expenses from commissions and fees shall include the costs of outsourcing services, only if the service is provided by the bank's parent, subordinated entity of the bank, or subordinated entity of the bank's parent.

Impairment of positions shall not be included in the calculation of the basic indicator.

The basic indicator shall be calculated on annual basis for the period terminating at the end of the financial year (December 31).

When audited financial statements are not available, the bank can use unaudited statements, when determining the basic indicator.

161. On the basis of the basic indicator, the bank can determine the capital requirement for operational risk by using one of the following two approaches:

- Basic Indicator Approach, in accordance with Section X.1 of this Decision;

- Standardized Approach, if the bank fulfilled the criteria stipulated in Section X.2 of this Decision.

162. The National Bank may set higher amount of capital requirements for operational risk, than the capital determined in accordance with Sections X.1 or X.2 of this Decision, if it determines that the capital fails to cover the bank's exposure to operational risk.

X.1 Basic indicator approach for determining capital requirements for operational risk

163. Under the Basic Indicator Approach, the capital requirements for operational risk shall be determined by multiplying the arithmetical mean of the three-year positive values of the basic indicator, determined in line with item 160 of this Decision, by 15%.

If in any of the three previous years, the bank's basic indicator is equal to or less than zero, the respective amount and the respective year shall not be included in determining the capital requirements for operational risk, i.e. they shall not be taken into account in the calculation of the arithmetical mean.

X.2. Standardized approach for determining capital requirements for operational risk

X.2.1 Criteria for implementation of the standardized approach

164. The bank can use the standardized approach for determining the capital requirements for operational risk, only if it fulfills all criteria for implementation of the standardized approach set forth in items 165, 166, 167 and 168 of this Decision (hereinafter: qualifying criteria).

165. The bank shall be obliged to allocate its financial activities in the business lines defined in Table 18 and to determine the basic indicator from item 160 of this Decision for each business line.

Table 18

Business lines	Activities	Ratio of capital requirements for business line
1	2	3
Services related to financing commercial entities, which according to the Law on Trade Companies are considered medium and large-scale commercial entities (corporate finance)	Purchase and sale, guaranteeing and/or placement (underwriting) of securities issue with an undertaken liability for redemption of the issue and services related to guaranteeing and/or placement	18%

	<p>Advice to legal entities on capital, business strategies etc.</p> <p>Services provided in mergers, acquisitions, acquiring shares or stakes in other companies, privatization</p> <p>Investment advice</p> <p>Services related to investment research and financial analysis, as well as other forms of general recommendations relating to transactions in financial instruments</p>	
Trading and sale	<p>Trading on its behalf and for its account</p> <p>Intermediation on the Money Market (money broking)</p> <p>Receipt and execution of orders related to one or more financial instruments, which are not included in the business line "Retail brokerage"</p> <p>Execution of orders on behalf of clients, placement of financial instruments without liability for their redemption (if not included in the business line "Retail brokerage")</p> <p>Operations of multilateral trading systems</p>	18%
Retail banking (natural persons and SC)	<p>Collection of deposits and other repayable funds</p> <p>Lending and other similar activities for client financing (financing of commercial projects, factoring, forfeiting etc.)</p> <p>Financial leasing</p>	12%

	Issuance of guarantees, backing guarantees and other similar instruments	
Commercial banking (medium and large-scale commercial entities in conformity with the Law on Trade Companies)	<p>Collection of deposits and other repayable funds</p> <p>Lending and other similar activities for client financing (financing of commercial transactions, factoring, forfeiting etc.)</p> <p>Financial leasing</p> <p>Issuance of guarantees, backing guarantees and other similar instruments</p>	15%
Payment operations and settlement	<p>Services in the national and international payment operations</p> <p>Issuance and administration of means of payment</p>	18%
Agent services	Providing services as a custodian-bank and other similar services and administrating of financial assets on the behalf of and for the account of the client	15%
Asset management	<p>Asset and portfolio management upon an order and for the account of the client</p> <p>Management of undertakings for collective investments (investment and pension funds)</p> <p>Other forms of asset management</p>	12%
Retail brokerage (natural persons and SC)	<p>Receipt and execution of orders for transfer of one or more financial instruments that are not included in the business line "Trading and sale"</p> <p>Execution of orders on the behalf of and for the account of clients, placement of financial instruments without</p>	12%

	an obligation for their redemption	
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166. The bank shall be required to establish and to apply policy for allocation of the activities by business lines, defining the principles for allocation of its financial activities in adequate business lines and determining the capital requirements for operational risk under the standardized approach.

The bank's Board of Directors shall be responsible for preparation and for adoption of the policy under paragraph 1 of this item. The bank's Supervisory Board shall be required to review and to approve this policy.

The policy under paragraph 1 of this item shall be subjected to regular revision and reconciliation with the financial activities the bank carries out and the risks it is exposed to as a result of those activities.

167. The bank shall allocate the financial activities to individual business line by the application of the following principles:

- all bank activities are covered;
- all activities that support other activity (auxiliary activity) are allocated to the business line of the basic activity. If the auxiliary activity is carried out to support several activities, the bank uses an objective-allocation criteria, and these criteria must be applied consistently in all similar cases;
- if the activity cannot be allocated in any business line, the respective activity is allocated into the business line with the highest capital requirements ratio (column 3 of Table 18). All associated auxiliary activities of that activity are allocated to the same business line;
- the costs generated in one business line, simultaneously referring to other business line, may be allocated to adequate business lines according to internal allocation methods;
- the allocation process of individual activities into business lines must be fully documented. The bank is obliged to have clear and detailed definitions for each business line;
- the allocation of the activities into business lines and the manner of calculation of the basic indicator are subject to independent review by the Internal audit department or audit house.

168. Besides the criteria under items 165, 166 and 167 of this Decision, the bank shall be obliged to fulfill also the following criteria for implementation of the standardized approach:

- the operational risk management system is fully documented and it covers the bank's overall operation;
- the rights and the responsibilities of the individual bank's bodies are clearly defined, as well as those of the bank's employees included in the operational risk management system;
- all relevant data for operational risk management are monitored, especially the data on the material losses arising from the exposure to this risk;
- system of regular reporting to the bank's bodies on exposure to operational risk and registered losses has been established, which enable obtaining adequate and timely data and information on the exposure to

- operational risk. The bank is obliged to have procedures for undertaking measures by appropriate bodies, on the basis of the obtained information;
- the operational risk management system is subjected to regular independent review by the Internal audit department and audit house.

The Internal audit department shall be obliged, before the application of the standardized approach, to determine the fulfillment of the qualifying criteria, as well as to conduct regular review whether the bank persists to meet the qualifying criteria.

X.2.2 Calculation of the capital requirements for operational risk by applying the standardized approach

169. The bank that fulfills the qualifying criteria shall determine the capital requirements for operational risk through calculation of the risk-weighted basic indicator for each business line and the risk-weighted basic indicator for each of the last three years.

The risk-weighted basic indicator for each business line shall be product of the basic indicator for that business line, set in line with items 160 and 165 of this Decision and the capital requirements ratio defined in column 3 of Table 18.

The sum of all risk-weighted basic indicators for each business line in one year, shall give the risk-weighted basic indicator for that year. When determining the risk-weighted basic indicator for certain year, all risk-weighted basic indicators for each business line shall be taken into account, regardless of their sign (positive or negative).

The capital requirements for operational risk shall be obtained when dividing the sum of the risk-weighted basic indicators for each of the last three years by 3. If the risk-weighted basic indicator for certain year is negative, the input to the calculation of the capital requirements for operational risk shall be zero.

170. The bank using the Basic indicator approach for determining the capital requirements for operational risk shall be obliged to notify the National Bank on the intention and the deadline within which it plans to use the standardized approach.

The bank shall be obliged to fulfill the qualifying criteria constantly. If the bank ceases to fulfill the qualifying criteria, it shall be obliged to submit a written explanation to the National Bank within five working days, listing the reasons for non-fulfillment of the criteria, the measures it undertakes to eliminate those reasons, as well as the deadline within which the qualifying criteria will be completely met.

The National Bank may order the bank different deadlines and measures than the measures and the deadlines stated in the written explanation under paragraph 2 of this item.

171. If, on the basis of the submitted written explanation under item 170 of this Decision or through its supervisory function, the National Bank determines that the bank no longer meets the qualifying criteria, nor it can provide fulfillment of the qualifying criteria within an appropriate period, it can order the bank to terminate the application of the standardized approach, i.e. to start determining the capital for operational risk by applying the basic indicator approach.

The bank applying the standardized approach cannot decide to revert to the basic indicator approach for determining the capital requirements for operational risk, without prior notification to the National Bank and its approval. The bank shall be obliged to state the reasons why it plans to revert to the utilization of the basic indicator approach for determining the capital for operational risk.

XI. TREATMENT OF OPTIONS

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

173. 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 174 and 175 of this Decision shall be accordingly included in the capital requirements for position risk (Sections VIII.3 and VIII.4 of this Decision), the capital requirements for currency risk (Section VII of this Decision) and the capital requirements for commodity risk (Section IX of this Decision).

174. The capital requirements for risk of purchased options, shall be the smaller of the following:

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

175. 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 ("in the money").

176. The bank shall not sell options without prior approval of the National Bank 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).

XII. USE OF CREDIT RATINGS TO DETERMINE THE RISK WEIGHTS

177. The bank may select one or more recognized ECAI or ECA whose credit ratings will be used to determine the level of credit quality, i.e. risk weight of certain categories of exposure.

The bank may use the credit assessments of recognized ECA only for the claims on central governments and central banks.

Notwithstanding paragraph 1 of this item, the bank can not choose recognized ECAI that is:

- A subsidiary of the bank;
- The bank's parent entity; or
- Entity in which the bank directly or indirectly participates or along with other banks, directly or indirectly owns more than 50% of the total number of shares or stocks or voting rights of that entity.

The bank shall be obliged to determine by internal act the method of selection of a recognized ECAI and the method of using its credit ratings.

178. The bank shall be obliged to make use of the credit ratings of the selected ECAI, i.e. the credit assessment of a recognized ECA, continuously and in the same way for all categories of exposure, i.e. for all types of credit products for which it has chosen the ECAI or ECA.

The bank may use the credit rating of the selected ECAI, i.e. the credit assessment of the selected ECA, only if that rating, i.e. assessment applies to the entire claim, i.e. exposure based on principal and interest.

179. The bank shall be obliged to use the requested credit ratings from recognized ECAI.

Notwithstanding paragraph 1 of this item, the bank may use unrequested credit ratings from recognized ECAI, only if the National Bank allowed the use of such ratings determined by that ECAI.

180. If for a particular category of exposure there is a credit rating by only one selected ECAI, i.e. credit assessment of only one selected ECA, that rating shall be used to determine the level of credit quality, i.e. the risk weight of the claim.

If for a certain category of exposure there are credit ratings, i.e. credit assessments by two selected ECAI and/or ECA, which correspond to different risk weights, the bank is required to apply the higher risk weight.

If for a certain category of exposure there are credit ratings, i.e. credit assessments by three or more selected ECAI and/or ECA, the bank is required to apply the higher of the two lowest risk weights.

181. When the bank's claim is on the basis of a financial instrument for which there is a long-term credit rating of a selected ECAI, the bank shall be required to use this rating to determine the risk weight of the claim (rather than the long-term credit rating of the debtor), on the basis of the corresponding table from Section VI of this Decision, for the exposure category to which the financial instrument or debtor belong.

If for the financial instrument from which the bank's claim arises has no long-term credit rating by a selected ECAI, but there is at least one credit rating by a selected ECAI for the debtor or any other financial instrument issued by that debtor, the bank shall be required to use the higher of the following two risk weights:

- 1) Higher risk weight of: (1) the weight that corresponds to the long-term credit rating of the debtor, or (2) the weight that corresponds to other financial instruments issued by the debtor; or
- 2) Risk weight which in accordance with Section VI of this Decision shall apply in cases when no long-term credit rating of the debtor has been determined.

182. The bank may not use the credit ratings of persons (or instruments issued by them) which together with the debtor belong to the same group of related persons in order to determine the risk weight of the claim of a particular debtor.

Notwithstanding paragraph 1 of this item, for a claim of a debtor which is a subsidiary of a parent entity, the bank shall apply:

- The risk weight determined on the basis of the credit rating of the parent entity (if the parent entity has a credit rating), or
- The higher of the following two weights: (1) 100% or (2) the risk weight of the central government where the headquarters of the parent entity is located.

183. Bank use short-term credit ratings for short-term claims on banks and other trade companies.

Short-term claims from paragraph 1 of this item shall be subject to the risk weights from the following table (Table 19), depending on the short-term credit rating of such claims:

Table 19

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

If the risk weight of the short-term claim (short-term financial instrument issued by a bank or other trade company) is 150%, the bank shall be required to use

the same weight for all other unsecured long-term and short-term claims on that particular debtor for which no credit rating by a recognized ECAI was established.

If the risk weight of the short-term claim (short-term financial instrument issued by a bank or other trading company) is 50%, the bank shall use the following risk weights:

- - 100% for all short-term claims on that particular debtor for which no credit rating by a recognized ECAI was established, if in accordance with item 181 paragraph 2 of this Decision, the risk weight of such claims is equal to or lower than 100%;
- - 150% of all short-term claims on that particular debtor for which no credit rating by a recognized ECAI was established, if in accordance with item 181 paragraph 2 of this Decision, the risk weight of such claims is 150%.

184. The bank may use the credit rating which refers to claims denominated in the domestic currency of the debtor only to determine the risk weight of those claims, and not for the claims on the debtor expressed in foreign currency.

Notwithstanding paragraph 1 of this item, the bank may use the credit rating which refers to a claim denominated in the domestic currency of the debtor to determine the risk weight of a claim on the debtor in foreign currency, if the bank's claim arises from a loan approved by multilateral development bank, in the approval of which the bank participated.

XIII.PROCEDURE AND CRITERIA FOR THE RECOGNITION OF ECAI

XIII.1 Recognition procedure

185. Each ECAI whose ratings will be used by a bank in the Republic of Macedonia for the purposes of this Decision shall file an application to the National Bank for its recognition (Annex 2).

Notwithstanding paragraph 1 of this item, the institutions: "Fitch Ratings", "Moody's" and "Standard & Poor's", which are considered to be recognized ECAI shall not be obliged to submit an application to the National Bank for their recognition.

186. The National Bank may carry out direct or indirect procedure for recognition of the ECAI and mapping of its credit ratings in appropriate levels of credit quality.

Direct ECAI recognition procedure means that the National Bank shall make an assessment of the compliance of the methodology and credit ratings of that particular ECAI with the criteria and conditions set out in Section XIII of this Decision.

Indirect ECAI recognition procedure means recognition of the ECAI, including the mapping of its credit ratings in appropriate levels of credit quality, without making assessment of the compliance of the methodology and credit ratings of that particular ECAI with the criteria and conditions set out in Section XIII of this Decision. Indirect recognition procedure may be implemented for the following ECAI:

- ECAI based in a Member State of the European Union which is registered in accordance with the provisions of Regulation 1060/2009 of the European Parliament and the Council, or

- ECAI already recognized by the competent authority of a Member State of the European Union.

187. Where ECAI at the same time files an application for recognition to the National Bank and the competent authorities of the European Union Member States, the National Bank may apply a procedure of mutual recognition with the other competent authorities. The role of the National Bank in the mutual recognition procedure will depend on the agreement reached with the other competent authorities that will participate in that procedure.

The purpose of the mutual recognition procedure is to perform joint ECAI recognition and to map its credit ratings in appropriate levels of credit quality.

National Bank's participation in the mutual recognition procedure shall not limit its right to request additional information from the ECAI which filed an application for recognition and to make an additional assessment of the application. The need for additional information and assessment may result from the specific requirements contained in the regulations of the Republic of Macedonia, which may not be covered by the mutual recognition procedure.

188. Regardless of the manner in which the recognition procedure is implemented, along with the application for recognition, the ECAI shall submit the following:

1) Proof that its credit ratings will be used for the purposes of this Decision, by at least one bank in the Republic of Macedonia (statement from Annex 3) whereby the bank:

- is not its parent entity or its subsidiary,
- has no direct or indirect participation in that particular ECAI, in cases when along with other banks in the Republic of Macedonia, directly or indirectly it owns more than 50% of the total number of shares or stocks or voting rights of that ECAI;

2) A common set of information (Annex 5) on the basis of which the National Bank shall determine whether the methodology and credit ratings of the ECAI meet the criteria defined in Section XIII of this Decision;

3) Proof that the ECAI has been registered in accordance with the provisions of Regulation 1060/2009 of the European Parliament and the Council or that it is recognized by the competent authority of a Member State of the European Union. This evidence shall be submitted only if the National Bank conducts indirect recognition procedure;

4) Statement of compliance of methodology and procedures for the entire group, if the ECAI as the parent entity of the group files an application for recognition at the group level (Annex 4), in accordance with item 190 of this Decision;

5) Adequate proof of recognition of the ECAI by the competent authorities of third countries and a statement signed by the ECAI that allows the competent authority

of the third country to submit to the National Bank all the documentation associated with the procedure of its recognition for the purposes of determining capital requirement for credit risk (if the ECAI is recognized by the competent authority of the country which is not a member of the European Union).

In the application from paragraph 1 of this item, ECAI is obliged to state the market segments for which it requires recognition. ECAI may require recognition for all basic market segments, for part of the basic market segments or for any other additional market segment, according to the exposure categories defined in this Decision.

In the recognition procedure the National Bank may request additional documentation to the documentation referred to in paragraph 1 of this item, if it deems necessary for the proper implementation of the procedure.

189. Documentation referred to in item 188 of this Decision shall be submitted in original or a copy certified by an authorized person (notary), signed by the authorized person or the appropriate authority of the ECAI, it shall be neat, without additional corrections, and in Macedonian language. If the required documentation is in another language, Macedonian translation shall be submitted along with the original, verified by a certified translator.

Notwithstanding paragraph 1 of this item, the documentation may be submitted in English, but the National Bank reserves the right to request translation of part or all of the documentation in the Macedonian language, verified by a certified translator, during the granting procedure.

190. ECAI may submit a request for recognition at the level of the whole group to which it belongs or at the level of a separate subsidiary.

The National Bank shall recognize the ECAI at the level of the whole group, if the ECAI may prove that all the group members - subsidiaries, apply the same credit ratings, methodology, procedures and practices for determining credit ratings.

If credit ratings, methodology, procedures, and practices of individual group members - subsidiaries differ significantly, the National Bank shall ask each subsidiary to file a separate application for recognition.

191. In all cases when it is determined that a particular ECAI meets the criteria stipulated in Section XIII of this Decision, the National Bank shall issue an approval to recognize that ECAI. The approval contains the market segments for which the credit ratings of the recognized ECAI may be used, as well as the manner of mapping of its credit ratings in appropriate levels of credit quality.

192. The National Bank keeps a list of recognized ECAI which it publishes and updates on its website in a timely manner.

The list referred to in paragraph 1 of this item shall contain at least the following information:

- The name of the recognized ECAI;
- Market segments for which its credit ratings may be used;

- The manner of mapping the credit ratings of the recognized ECAI according to the degrees of credit quality;
- Designation whether a bank in the Republic of Macedonia may use unrequested credit ratings assigned by a recognized ECAI.

In addition to the list of recognized ECAI, the National Bank shall timely publish data on all cases when reassignment of credit ratings of the recognized ECAI was performed, or when it fully or partially withdrew the approval for recognition.

XIII.2 Recognition criteria

193. When deciding on the recognition of a particular ECAI, the National Bank shall assess:

- The compliance of its methodology with the criteria of objectivity, independence, continuous monitoring and review and transparency, according to Section XIII.2.1 of this Decision;
- The reliability and market use of its credit ratings, as well as their transparency, according to Section XIII.2.2 of this Decision.

XIII.2.1 Criteria for evaluation of the ECAI methodology

194. The methodology is considered impartial if it is conservative, systematic, consistent and subject to continuous validation based on empirical evidence.

If the ECAI uses different methodologies for assigning credit ratings of various market segments, it is obliged to explain the characteristics of each methodology. The National Bank shall separately consider and evaluate different methodologies and it may take a decision on recognition of the ECAI for all or part of the market segments for which that ECAI has filed an application for recognition.

The National Bank shall assess the fulfillment of the criterion of objectivity of the methodology through the following factors:

- Using quantitative techniques (such as transition matrices or techniques for analyzing the default rates) proving the comprehensiveness of the methodology for assigning credit ratings and its ability to forecast the credit rating over time, for different categories of exposure;
- Evidence that the methodology provides and applies actions/procedures for assessing the factors affecting the credit ability of the legal entity or financial instrument that is assessed;
- Evidence of consistent application of the methodology when determining credit ratings within individual market segments.

195. ECAI methodology should be independent from political influences and constraints, as well as economic impacts on individual credit ratings.

Independence of the methodology is evaluated on the basis of the following factors:

- Ownership and organizational structure of the ECAI;
- Funding sources of the ECAI;
- Number of employees and their expertise;

- Corporate governance of the ECAI.

For the purposes of determining the independence of the methodology in accordance with paragraphs 1 and 2 of this item, ECAI is required to submit documentation to confirm that:

- there are adequate mechanisms to protect the independence of the procedure for determining credit ratings from the impact of the ownership structure of the ECAI;
- the organizational structure of the ECAI allows clear functional and organizational separation of the activity of determining the credit ratings from the other activities of the ECAI which may adversely affect the impartiality of the credit rating (e.g., provision of advisory services);
- there are adequate mechanisms to protect the ECAI from the impact of significant and large customers (in terms of the amount of their share in the total revenues of the ECAI) on the impartiality of the credit rating;
- it has an adequate number of employees in relation to the scope of its operations, which will enable consistent application of the methodology and continuous cooperation with customers, when it is provided with the methodology (as a way to collect the data and information necessary for determining the credit rating). Employees should have the appropriate experience and expertise needed to accomplish the assigned tasks (e.g., at least one person in the team which analyzes and decides on the degree of the credit rating to have at least three years experience as a credit analyst or in a similar position);
- regular and independent internal audit of the procedure for determining credit ratings is performed;
- appropriate written internal working procedures, rules of corporate governance, policies on the amount of fees and a code of conduct are established, which ensure the integrity of the procedure for determining credit ratings;
- mechanisms are established, for identification of current and potential cases of conflict of interest, for taking appropriate measures for the prevention, management or elimination of such cases and for their publication.

196. The methodology should provide for continuous monitoring and revision of credit ratings, as well as an obligation to change credit ratings depending on the changes in the financial condition of the client to which the rating pertains. The revision should be conducted at least once a year, and more frequently if there is a significant event which may imply a change in the credit rating.

A significant event denotes any change (financial, market-related or any other change) which is large enough to cause, immediately or in the near future, a change in the credit rating assigned by the ECAI (regardless of whether it is a rating of the client or securities issued by that client).

The assessment of the fulfillment of the criterion for continuous monitoring and revision is done by the following factors:

- confirmation of credit ratings on the basis of empirical evidence that should be performed at least once a year, for each market segment -

- comparison of the assigned rating of a particular customer (or its securities issues) with actual results achieved in the previous period;
- internal procedures for monitoring and identifying changes in the internal and external factors for each client which may represent an important event in terms of paragraph 2 of this item;
- possibility of getting information about the cooperation and contacts with clients of the ECAI to which it assigned credit ratings - on request of the National Bank, the ECAI shall submit all information related to the scope of the contacts with the governing bodies of its clients;
- timely reporting to the National Bank of any significant changes in the methodology of the ECAI - the National Bank should be informed immediately of any significant changes in the methodology. As significant changes in methodology are considered at least the changes in the information supplied as part of the usual package of information.

197. It is considered that the methodology of the ECAI is transparent if the ECAI publishes the basic principles of the procedure for determining the credit ratings, in a way that is simple and understandable to potential users.

Transparency of the methodology is evaluated by:

- The volume of information that the ECAI publishes - published information pertain at least to the description of the individual categories of credit ratings and timely notice of significant changes in the methodology;
- The manner in which that information is published - website of the ECAI, free of charge publications and the like.

XIII.2.2 Criteria for the assessment of credit ratings

198. Individual credit ratings of the ECAI should be credible and accepted by the market, which is proven through evaluation of the following factors:

- Market utilization expressed as a share of the credit ratings of the ECAI in each market segment or geographic region;
- The amount of total income of the ECAI from assigning credit ratings generated on individual market segments;
- Any connection between the method of determining prices (fees) charged by the ECAI for assigning credit ratings, and the procedure for determining credit ratings;
- Credit ratings of the ECAI are used or will be used by at least two banks based in the Republic of Macedonia for the purpose of credit risk management by those banks.

199. Transparency of credit ratings assigned by the ECAI means making them available on equal terms to all interested banks, at the time when those credit ratings are assigned or revised by the ECAI, whether the ECAI charges for that approach or not.

The term "equal conditions" means having equal economic conditions for access to credit ratings assigned by the ECAI, i.e. absence of price discrimination. "Interested banks," pertains to banks, regardless of their headquarters, which

determine the required level of capital to cover credit risk as determined by this Decision.

XIII.3 Mapping of credit ratings

200. The National Bank shall map the credit ratings of recognized ECAI in the degrees of credit quality and the appropriate risk weights specified in Section VI of this Decision.

The mapping from paragraph 1 of this item shall be made during the procedure for the recognition of the respective ECAI, and in the course of its monitoring.

201. The National Bank shall map the long-term credit ratings of the recognized ECAI by applying the quantitative and qualitative factors specified in Sections XIII.3.1 and XIII.3.2 of this Decision.

202. The National Bank shall map the short-term credit ratings of the recognized ECAI considering the mapping of its long-term credit ratings made in accordance with item 201 of this Decision, and based on internal mapping done by the ECAI and submitted in the usual information package.

203. The National Bank shall map the credit ratings of stocks in investment funds of the recognized ECAI considering the mapping of its long-term credit ratings made in accordance with item 201 of this Decision, and based on internal mapping of acceptable credit ratings of shares in investment funds made by ECAI and information submitted in the usual package.

Acceptable credit ratings of the stocks in investment funds are considered those credit ratings where the credit assessment for the most part is based on the credit quality of the assets of the investment fund. Other factors (quality of management of the fund, the fund's sensitivity to changes in the market, the level of diversification of the fund, the maturity matching of assets and liabilities of the fund, etc.) may be partly taken into account in determining the credit rating, depending on their size and nature.

204. Notwithstanding this Section, the requested credit ratings of "Fitch Ratings", "Moody's" and "Standard & Poor's" are mapped in the degrees of credit quality from Section VI of this Decision, in the manner set out in Annex 6. The bank, which for individual market segments uses requested credit ratings of these three institutions, determines the weighted value of the individual categories of exposure, based on the classification from Annex 6.

XIII.3.1 Quantitative factors

205. ECAI is obliged to submit to the National Bank the following quantitative factors that are used as the basis for the mapping of its credit ratings:

- Realized ten-year average of the three-year cumulative default rate of all entities to whom ECAI awarded the same long-term rating;

- The last two three-year cumulative default rates of all entities to whom ECAI awarded the same long-term rating.

In case of a newly-established ECAI or ECAI that does not have long enough data series to determine the required default rates from paragraph 1 of this item, it shall submit to the National Bank the estimated, i.e. the expected default rates of all entities who were granted the same long-term rating.

206. The National Bank shall compare the quantitative factors of item 205 of this Decision, at the following comparative rates:

- The rate from item 205, paragraph 1, indent 1 shall be compared with the long-term comparative three-year cumulative default rate (Table 20);
- The rate from item 205, paragraph 1, indent 2 shall be compared with the monitoring and reassessment rates (Table 21).

Table 20

Credit quality level	1	2	3	4	5
Long-term comparative three-year cumulative default rate	0,10%	0,25%	1,00%	7,50%	20,00%

Table 21

Credit quality level	1	2	3	4	5
Monitoring rate	0,8%	1,0%	2,4%	11,0%	28,6%
Reassessment rate	1,2%	1,3%	3,0%	12,4%	35,0%

The National Bank shall initially map the credit ratings of recognized ECAI through the comparison from paragraph 1, indent 1 of this item. Initial mapping is confirmed using the monitoring and reassessment rates, as follows:

- If the last three-year cumulative default rate for a certain degree of credit quality in which the appropriate credit rating was mapped is above the monitoring pertaining to that degree of credit quality (Table 20, row 2), the National Bank shall review the reason for the occurrence of a difference. Reassignment of the credit rating in a less favorable level of credit quality will be made if the National Bank finds that the higher default rate is a result of worse standards for the credit assessment or calculation errors made by recognized ECAI;
- If the last two three-year cumulative rates of recovery for a particular degree of credit quality in which the credit rating was mapped are higher than reassessment rate which refers to that degree of credit quality (Table 21, row 3), the National Bank will shift the credit rating into a less favorable level of credit quality.

XIII.3.2 Qualitative factors

207. During mapping of the credit ratings of recognized ECAI, the National Bank shall take into account also the following qualitative factors:

- Size and scope of the customers/issuers of securities ranked by the recognized ECAI;
- Range of credit ratings awarded by the recognized ECAI;
- Meaning of each credit rating;

- Definition of default rate.

XIII.4 Monitoring of recognized ECAI

208. Recognized ECAI is obliged to meet constantly the criteria defined in Section XIII of this Decision on the basis of which it is recognized by the National Bank.

209. Recognized ECAI is obliged to inform the National Bank on:

- Any significant change in its methodology which affects the fulfillment of the criteria of Section XIII of this Decision (in accordance with item 196 of this Decision);
- The three-year cumulative rates of payment for the previous year for each market segment for which it is recognized by the National Bank (the data to be submitted by the end of the current year);
- The usual packet of information (to be submitted every five years); and
- Other information that may be requested by the National Bank for the purposes of this Decision.

ECAI that is recognized by the competent authority of another country shall immediately notify the National Bank if that supervisory authority had it withdrawn from the list of recognized ECAI or changed the manner of mapping of its credit ratings.

210. Based on information from item 209 of this Decision, the National Bank shall regularly monitor the:

- Completion of mapping of credit ratings of the recognized ECAI
- Fulfillment of the criteria defined in Section XIII of this Decision by the recognized ECAI (at least every five years).

211. In all cases where the National Bank determines that the completion of mapping no longer corresponds to the actual level of credit quality, it shall reassess the mapping according to Section XIII.3 of this Decision.

Recognized ECAI in which the National Bank conducted the re-mapping of its credit ratings, according to Section XIII.3 of this Decision may seek reassessment of mapping by providing adequate evidence proving that cumulative default rates are no longer significantly larger than the values of comparative rates. In these cases, the National Bank may reassess mapping and re-map credit ratings of that ECAI into a more favorable degree of credit quality.

If the competent authority of a European Union Member State made a mapping of credit ratings of the recognized ECAI different from the mapping carried out by the National Bank, the National Bank may adjust its own mapping to the mapping carried out by that supervisory authority.

XIII.5 Withdrawal of the issued approval

212. The National Bank may fully or partially withdraw the issued approval for the recognition of certain ECAI.

The National Bank may fully withdraw the issued approval if it finds that:

- The recognized ECAI does not meet the criteria defined in Section XIII of this Decision;
- ECAI that was recognized in an indirect recognition procedure was deprived of the approval by the relevant competent authority of a European Union Member State or ceased to be registered in accordance with Regulation 1060/2009 of the European Parliament and the Council;
- Recognized ECAI does not fulfill the requirements regarding the submission of information and data to the National Bank, in accordance with paragraph 209 of this Decision; or
- Recognized ECAI uses the approval of the National Bank for its advertising and marketing needs.

The National Bank may partially withdraw the approval for the use of credit ratings of the recognized ECAI for a certain market segment in case it determines that:

- Recognized ECAI does not meet the criteria defined in Section XIII of this Decision only for a certain market segment;
- ECAI that was recognized in an indirect recognition procedure was deprived of the approval by the relevant competent authority of a European Union Member State to use its ratings for a particular market segment.

213. In addition to the cases referred to in item 212 of this Decision, the National Bank may withdraw completely or partially the approval for recognition of certain ECAI also upon obtaining a proof that another authority has deprived it of the approval.

214. In addition to the cases referred to in item 212 of this Decision, the National Bank may withdraw the approval for the recognition of certain ECAI allowing banks to use unrequested credit ratings assigned by that ECAI, for the purposes of this decision, if it determines that:

- The quality of the unrequested credit ratings is considerably worse than the quality of the requested credit ratings;
- The recognized ECAI used the unrequested credit ratings as a means to force the entities that these ratings refer to, to ask from that ECAI awarding of requested credit ratings (ratings that are paid).

215. In cases where the National Bank gave approval for recognition of an ECAI at a group level, the National Bank may withdraw a part of the issued approval for a separate subsidiary that is a member of the group, if it determines that the subsidiary:

- Does not use the same credit ratings, methodology and procedures as the parent entity (the entity which on behalf of the group received an approval for the group's recognition by the National Bank);
- Uses the approval for its advertising and marketing purposes;
- Uses the unrequested credit ratings as a means to force the entities that these ratings refer to, to ask from it awarding of requested credit ratings (ratings that are paid).

XIV. CAPITAL ADEQUACY ON A CONSOLIDATED BASIS

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

The 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.

217. The 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.

The 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 29 and 30 of this Decision.

218. 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.

XIV.1 Determining own funds on a consolidated basis

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

220. The own funds of the banking group shall be determined in consistence with Section III 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:

- the amount of minority interest and the amounts of qualifying Additional Tier I capital, qualifying Tier I capital, qualifying Tier II capital and qualifying own funds of a subsidiary of the bank in accordance with items 220-a and 220-b of this decision;
- each difference determined as a result of the consolidation, including the reserves from foreign exchange differences arising on consolidation,
- participation of the group members in third parties for which the National Bank 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 Common Equity Tier I capital, Additional Tier I capital and Tier II capital of the banking group. If these positions have a negative value, they represent a deduction from the Common Equity Tier I capital, Additional Tier I capital, and Tier II capital, respectively.

220-a. The minority interest, the qualifying Additional Tier I capital, qualifying Tier I capital, qualifying Tier II capital and qualifying own funds shall consist of the positions of the Common Equity Tier I capital, the positions of the Additional Tier I capital and the positions of the Tier II capital of a subsidiary of the bank, respectively, that belong to third parties.

The minority interest and the amounts of the qualifying Additional Tier I capital, the qualifying Tier I capital and the qualifying Tier II capital of the subsidiary shall be included in the respective part of the bank's own funds on a consolidated basis if:

- the subsidiary is a bank;
- the subsidiary is a member of the banking group of the bank subject to consolidated supervision;
- third parties that have invested in positions that are part of the own funds of the bank's subsidiary are not members of the banking group of the bank subject to consolidated supervision.

The minority interest and the amounts of the qualifying Additional Tier I capital, the qualifying Tier I capital and the qualifying Tier II capital of the subsidiary that are directly or indirectly funded by the bank (the parent) or its subsidiary, may not be included in the calculation of the bank's own funds on a consolidated basis.

220-b. The amount of the minority interest of a subsidiary that can be included in the bank's Common Equity Tier I capital on a consolidated basis is equal to the product of:

- 1) the lower amount between:
 - the amount of the Common Equity Tier I capital of the subsidiary required for fulfilling the capital requirement, taking into account the provisions of item 10 of this decision, the total internal capital for covering risks, the capital buffers, as well as any other amount to be maintained by the subsidiary in accordance with the regulations or the requirements of the competent authority;
 - the amount of the Common Equity Tier I capital of the subsidiary to be maintained for the purposes of determining the Common Equity Tier I capital on a consolidated basis for fulfilling the capital requirement, taking into account the provisions of item 10 of this decision, the total internal capital for covering risks, the capital buffers, as well as any other amount to be maintained by the subsidiary in accordance with the regulations or the requirements of the competent authority;
- 2) the ratio between the amount of the Common Equity Tier I capital that belongs to third parties that have investments in the subsidiary and the total amount of the Common Equity Tier I capital of the subsidiary, expressed as a percentage.

The amount of the qualifying Tier I capital of a subsidiary that can be included in the bank's own funds on a consolidated basis is equal to the product of:

- 1) the lower amount between:
 - the amount of the Tier I capital of the subsidiary required for fulfilling the capital requirement, taking into account the provisions of item 10 of this decision, the total internal capital for covering risks, the capital buffers, as well as any other amount to be maintained by the subsidiary in accordance with the regulations or the requirements of the competent authority;

- the amount of the Tier I capital of the subsidiary to be maintained for the purposes of determining the Tier I capital on a consolidated basis for fulfilling the capital requirement, taking into account the provisions of item 10 of this decision, the total internal capital for covering risks, the capital buffers, as well as any other amount to be maintained by the subsidiary in accordance with the regulations or the requirements of the competent authority;
- 2) the ratio between the amount of the Tier I capital that belongs to third parties that have investments in the subsidiary and the total amount of the positions of the Tier I capital of the subsidiary, expressed as a percentage.

The amount of the qualifying Additional Tier I capital of the subsidiary that is included in the Additional Tier I capital of the bank on a consolidated basis shall be equal to the difference between the amount of the qualifying Tier I capital referred to in paragraph 2 of this item and the amount of the minority interest referred to in paragraph 1 of this item.

The amount of the qualifying own funds of a subsidiary that can be included in the bank's own funds on a consolidated basis is equal to the product of:

- 1) the lower amount between:
 - the amount of own funds of the subsidiary required for fulfilling the capital requirement, the total internal capital for covering risks, the capital buffers, as well as any other amount to be maintained by the subsidiary in accordance with the regulations or the requirements of the competent authority;
 - the amount of own funds of the subsidiary to be maintained for the purposes of determining the own funds on a consolidated basis for fulfilling the capital requirement, the total internal capital for covering risks, the capital buffers, as well as any other amount to be maintained by the subsidiary in accordance with the regulations or the requirements of the competent authority;

2) the ratio between the amount of own funds of third parties that have investments in the subsidiary and the total amount of the positions of the own funds of the subsidiary, expressed as a percentage.

The amount of the qualifying Tier II capital of the subsidiary included in the bank's Tier II capital on a consolidated basis shall be equal to the difference between the amount of qualifying own funds referred to in paragraph 4 of this item and the amount of qualifying Tier I capital referred to in paragraph 2 of this item.

XIV.2 Determining credit risk weighted assets on a consolidated basis

221. 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.

222. 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 equal to 8% of the amount of credit risk weighted asset of the banking group referred to in paragraph 1 of this item.

XIV.3 Determining other risk weighted assets on a consolidated basis

223. Other risk weighted assets 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 224 of this Decision, the capital requirements for the market risks to the banking group as determined by item 225 of this Decision, the capital requirements for operational risk as determined by item 226 of this Decision and the capital requirements for commodity risk as determined by item 227 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, the capital requirements for operational risks and the capital requirements for commodity risk to the banking group, an aggregated method shall be used as defined by items 224, 225, 226 and 227 of this Decision.

224. 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.

225. 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 among group members.

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

226. Each member of the banking group shall determine the capital requirement for operational risk on an individual basis, in accordance with Section X 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 operational risk to the banking group.

227. Each banking group member shall determine the capital requirements for commodity risk (risk of changing commodity prices) 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.

228. Notwithstanding item 223 paragraph 2 of this Decision, upon prior approval of the National Bank, 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 net position in gold and aggregate foreign exchange position and permanently monitors the market risks, the currency risk and the commodity risk related to such positions across the group and on a regular basis,
- each group member shall, on individual basis, maintain the set capital adequacy ratio,
- the parent entity has adequate expertise 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 National Bank issues 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.

XV. REPORTS

229. The banks shall compile reports on the implementation of this Decision by the accounting value as of March 31, June 30, September 30 and December 31 and submit them to the National Bank.

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

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

Notwithstanding paragraph 1 of this item, the bank subject to consolidated supervision shall submit the capital adequacy reports 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 reports on individual basis.

230. Upon special request of the National Bank, the bank shall compile reports as of other dates and within deadlines different from those indicated in item 229 of this Decision.

XVI. TRANSITIONAL AND FINAL PROVISIONS

231. Guidelines adopted by the Governor of the National Bank shall prescribe the manner of implementation of this Decision.

232. Savings banks and foreign bank branches shall be obliged to apply the provisions of this Decision, having regard to the provisions of the Banking Law and regulations adopted pursuant to this Law governing the operations of savings banks and foreign bank branches in the Republic of Macedonia.

233. Contracts for hybrid capital instruments and subordinated instruments concluded by the date this Decision enters into force shall be subject to the regulations that were applicable on the date of their conclusion. In case of extension of the contract for a hybrid instrument or subordinated instrument signed by the date this Decision enters into force, the bank shall be obliged to harmonize that contract with the provisions of this Decision.

234. Annexes 1, 2, 3, 4, 5 and 6 are an integral part of this Decision.

235. On the day the savings houses start implementing this Decision, the Decision on the methodology for determining capital adequacy ("Official Gazette of the Republic of Macedonia" no. 159/2007, 32/2008, 31/2009, 96/2009, 157/2009 and 91/2011) ceases to be effective.

236. This Decision shall enter into force on the eighth day of its publication in the "Official Gazette of the Republic of Macedonia", and shall be applicable from 01.07.2012 for banks and foreign bank branches, i.e. from 01.07.2013 for savings houses.

D. No. 02-15/III-1/2012
March 29, 2012
Skopje

Dimitar Bogov
Governor

Chairman
of the National Bank of the Republic
of Macedonia Council

Annex 1

Financial derivative	Risk of investments in debt instruments		Risk of investments in equity instruments	
	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 instruments		Yes, as a position in a zero-coupon debt instrument	Yes	Yes, as underlying position
- stock exchange indices		Yes, as a position in a zero-coupon debt instrument	Yes	Yes, as underlying position
Forward rate agreements	No	Yes, as two positions		
FX forward	No	Yes, as one position in each currency		
Swap	No	Yes, as two positions	Yes	Yes, as two underlying position

Annex 2

**REQUEST FOR RECOGNITION OF _____
for a recognized external credit assessment institution for the purposes of
determining the capital requirement for credit risk**

I. DATA ON THE INSTITUTION'S AUTHORIZED PERSON

(to be circled): Mr. / Ms.

Name:

Surname:

Job position:

Address of residence (permanent or temporary):

Postal code and city/town:

Country:

Phone:

Fax:

E-mail:

II. DATA ON THE LEGAL REPRESENTATIVE²

(to be circled): Mr. / Ms.

Name:

Surname:

Job position:

² To be filled-in in case of issued a power of attorney for submission of a request for recognition.

Address of residence (permanent or temporary):

Postal code and city/town:

Country:

Phone:

Fax:

E-mail:

POWER OF ATTORNEY

I, the undersigned, empower _____ (name and surname of the legal representative) to be my legal representative and to file, on my behalf, a request for recognition of _____ (name of institution) by the National Bank of the Republic of Macedonia, as a recognized external institution for credit risk assessment for the purposes of determining the capital requirement for credit risk.

Signature of the institution's authorized person

III. SUMMARY INFORMATION

1. Market segment subject of the requested recognition:

2. Name and address of subsidiaries for which the institution files for recognition:

3. List of countries in which the institution files for, or intends to file for recognition (please circle or fill-in):

1. Austria

2. Belgium
3. Bulgaria
4. Cyprus
5. Czech Republic
6. Denmark
7. Estonia
8. Finland
9. France
10. Germany
11. Greece
12. Hungary
13. Ireland
14. Italy
15. Latvia
16. Lithuania
17. Luxembourg
18. Malta
19. The Netherlands
20. Poland
21. Portugal
22. Romania
23. Slovakia
24. Slovenia
25. Spain
26. Sweden
27. Great Britain
28. Island
29. Lichtenstein
30. Norway
31. Others:

IV. ANNEXES (please circle or fill-in)

1. Statement of a bank in the Republic of Macedonia for the intention to use credit ratings of the institution for the purposes of determining the capital requirement for credit risk (Annex 3);
2. Statement on compliance with credit ratings, methodology, procedures and practices for determining credit ratings of the group of the institution (Annex 4);
3. Filled-in common package of information as specified by Annex 5 of this Decision;
4. Other:

Institution (name and address):

Place and date:

Name and surname of the authorized person / legal representative of the institution:

Signature of the authorized person / legal representative of the institution:

Annex 3

STATEMENT ON THE PURPOSE OF USING CREDIT RATINGS OF

We, in the capacity of members of the Management Board of _____
(bank's name and address), confirm that if _____ (institution's name) is
recognized by the National Bank of the Republic of Macedonia, _____ (bank's
name) will apply the institution's ratings in the calculation of the capital requirement
for credit risk, using a standardized approach.

Place and date:

Name and surname of the members of the Management Board of _____
(bank's name):

Signature of the members of the Management Board of _____ (bank's
name):

Annex 4

STATEMENT ON THE COMPLIANCE OF THE METHODOLOGY AND PROCEDURES WITHIN THE GROUP OF THE INSTITUTION

I, the undersigned, confirm that the following ECAI subsidiaries:

(name and address of ECAI's subsidiary/ies) apply the same credit ratings, methodology, procedures and practices for determining credit ratings for each indicated market segment (please fill-in, if necessary):

Place and date:

Name and surname of the authorized person / legal representative of the institution:

Signature of the authorized person / legal representative of the institution:

Annex 5

COMMON PACKAGE OF INFORMATION

I. BASIC INFORMATION

1. Type of credit rating to be issued: requested and/or unrequested, with a summary description of reasons behind the decision to issue such type of credit rating.
2. Countries in which the institution has been operating (issues credit ratings).
3. Review of the ownership and organizational structure of ECAI and its group: ownership, larger subsidiaries, auxiliary and other services offered by the institution, etc. Information on ownership should be included in the list of shareholders/members holding above 10% of ECAI 's shares/stakes.
4. Total number of permanent full-time employees.
5. Number of largest clients and/or subscribers and their percentage share in ECAI 's income (e.g. clients and subscribers holding above 5% of total ECAI's income).
6. Information on the financial position of ECAI: financial statement on the previous three years and projection for the following three years (in case of their unavailability, a statement on the financial support issued by the parent entity of the group of the institution).
7. Statement on adhering to the code of conduct that contains standards accepted by the market and internationally recognized codes of conduct.

II. INFORMATION CONFIRMING THE FULFILLMENT OF RECOGNITION CRITERIA³

1. IMPARTIALITY OF METHODOLOGY

1.1. Full description of the methodology and the process of development, application and amendment of methodology. The description should include description of the process applied for providing full and single application of the methodology for all market segments, with a special assessment of the role of the ranking boards and the procedures they apply, the volume of information received by entities whose credit rating is being determined, the access and use of non-public information, etc.

1.2. Detailed description of quantitative factors: key indicators, sources of data, assumptions and applied quantitative techniques, scope of information from entities whose credit rating is being determined (for all market segments where the basic methodology is applied).

³ The institution shall not repeat the replies, but shall unambiguously indicate, for each criteria, the differences between market segments the recognition request refers to.

1.3. Detailed description of qualitative factors, particularly the scope of using qualitative and biased assessments for the quality of strategy, business plan of entities whose credit rating is being assigned, etc. (for all market segments that apply the basic methodology).

1.4. Review of basic differences in the methodology applied in certain geographic regions (if any).

1.5. Description of methodology applied for confirming the accurateness, consistence and comprehensiveness of the credit rating system and its capability, with a detailed analysis, to predict the results and conclusions from the analysis.

2. INDEPENDENCE OF THE METHODOLOGY

2.1. Detailed description of procedures for assigning realistic and impartial credit ratings, i.e. description of mechanisms of recognition, prevention, management or elimination of current or potential cases of conflicts of interests.

2.2. Detailed description of mechanisms for protection of the procedure for determining credit ratings in case of assignment of ratings to shareholders/members of ECAI or other persons connected to ECAI.

2.3. Evidence and statement on existence of an independent internal audit function or other instruments for facilitating efficient implementation of internal procedures for assigning, verification and withdrawal of credit rating.

2.4. Evidence and statement of the members of ranking teams and boards that they have the necessary experience and skills to determine credit ratings, and evidence for permanent development of their skills through adequate trainings.

2.5. Description of basic features of the established code of conduct of the ECAI.

2.6. Evidence and statement that the policy of awarding the credit rating officers does not affect the development of independent and fair credit rating (e.g. evidence that the award of analysts does not depend on the decision-making of assigning credit rating, uncollected fees and other income from investors or subscribers).

2.7. Information on the single pricelist of ECAI.

2.8. Evidence/statement that staff members, involved in the process of determining credit rating, are not in a business relationship with the entities whose credit rating is being determined, and which may prevent the development of independent and qualitative credit rating.

3. PERMANENT MONITORING AND REVISION OF CREDIT RATINGS

3.1. Basic information on the permanent monitoring of determined credit ratings, such as established monitoring procedures and their basic features, scope, interval and staff members/teams involved in the monitoring, basic stages of the process of monitoring, updating, inclusion of information from entities whose rating is being determined, warning system,

mechanisms the make sure that systemic errors that occur during the determination of ratings will be taken into account in the future amendments to the credit rating methodology, etc..

3.2. Summary of the revision results.

3.3. Evidence that the credit ratings are being confirmed on the basis of historical experience, at least once every year.

3.4. Scope of cooperation with the management bodies of clients whose credit rating is being determined.

4. TRANSPARENCY OF THE METHODOLOGY

4.1. Evidence that the basic principles for credit rating assignment methodology are being disclosed.

4.2. Description of the information disclosure method, as well as the terms and conditions under which any interested user may have an access to credit ratings assigned by the institution.

4.3. Description of credit rating transparency policy, depending on the type of credit rating: requested or unrequested.

5. CREDIT RATING RELIABILITY

5.1. Evidence for market acceptability of the institution's credit ratings, such as: market share, number of clients with assigned credit rating, information on the period of market activities of ECAI, total income generated on the basis of determining credit ratings.

6. TRANSPARENCY OF THE CREDIT RATING

6.1. Detailed description of the procedure for credit rating public disclosure.

III. INFORMATION REQUIRED FOR CREDIT RATING ASSIGNMENT

1. INFORMATION ON LONG-TERM CREDIT RATING ASSIGNMENT

1.1. Definition of default rate.

1.2. Three-year cumulative default rate for each credit rating (to be submitted to the National Bank on annual basis, in case of recognition of ECAI) and at least the last two three-year cumulative default rates.

1.3. Ten-year average of three-year cumulative default rates. If these rates are not available to the ECAI, it shall submit the perceived, i.e. expected liabilities default rates.

1.4. In case of application of predetermined (targeted) probability of default, information submitted on such determined collection probability for each credit rating category.

1.5. Description of methodology for calculating three-year aggregate default rates: selection of portfolio (static or dynamical portfolio), default definition, calculation of the number of defaults (weighting method).

1.6. Statistical significance of default rate.

1.7. Dynamical features of the credit rating methodology (static, i.e. in a given time or dynamical i.e. ranking methodology that takes into account the business cycle).

1.8. Definition (significance) of credit rating categories.

1.9. Spread of credit ratings assigned by ECAI.

1.10. Period of determining the credit rating.

1.11. Transition matrix.

1.12. Geographic coverage.

2. ADDITIONAL INFORMATION FOR DETERMINING CREDIT RATING OF INVESTMENT FUNDS

2.1. Review of credit ratings of stakes in investment funds that start from the assessment of credit quality of the fund's assets (fund's investments).

2.2. Description of factors and their influence on the credit rating.

2.3. Definition (significance) of credit rating categories.

2.4. Spread of credit ratings assigned by ECAI.

2.5. Period of determining the credit rating.

2.6. Transitional matrix.

2.7. Geographic coverage.

2.8. Relation between the credit rating of investment fund and the long-term credit ratings of ECAI.

3. INFORMATION ON OF SHORT-TERM CREDIT RATING ASSIGNMENT

3.1. Relation between the short-term and long-term credit ratings of ECAI.

Annex 6

ASSIGNMENT OF REQUESTED CREDIT RATINGS OF FITCH RATINGS, UK, MOODY'S INVESTORS SERVICES LTD, UK AND STANDARD & POOR'S RATINGS SERVICES TO THE RESPECTIVE CREDIT QUALITY LEVELS

Assignment of long-term credit ratings in respective credit quality levels

Credit quality level	Central governments and central banks	Local government, regional government, public sector entities, multilateral development banks and international organizations	Banks		Other trade companies	Fitch	Moody's	Standard & Poor's
			Residual maturity of up to 3 months	Residual maturity of above 3 months				
1	0%	20%	20%	20%	20%	AAA to AA-	Aaa to Aa3-	AAA to AA-
2	20%	50%	20%	50%	50%	A+ to A-	A1 to A3	A+ to A-
3	50%	50%	20%	50%	100%	BBB+ to BBB-	Baa1 to Baa3	BBB+ to BBB-
4	100%	100%	50%	100%	100%	BB+ to BB-	Ba1 to Ba3	BB+ to BB-
5	100%	100%	50%	100%	150%	B+ to B-	B1 to B3	B+ to B-
6	150%	150%	150%	150%	150%	CCC+ and below CCC+	Caa1 and below Caa1	CCC+ and below CCC+

Assignment of short-term credit ratings to banks and other trade companies

Credit quality level	Weight	Fitch	Moody's	Standard & Poor's
1	20%	F-1+, F-1	P-1	A-1+, A-1
2	50%	F-2	P-2	A-2
3	100%	F-3	P-3	A-3
4 to 6	150%	Below F-3	N/A	B-1, B-2, B-3, C

Assignment of long-term credit ratings to stakes in investment funds

Credit quality level	Weight	Fitch	Moody's	Standard & Poor's
1	20%	AAA to AA-	Aaa to Aa3-	AAA to AA-
2	50%	A+ to A-	A1 to A3	A+ to A-
3	100%	BBB+ to BBB-	Baa1 to Baa3	BBB+ to BBB-
4	100%	BB+ to BB-	Ba1 to Ba3	BB+ to BB-
5	150%	B+ to B-	B1 to B3	B+ to B-
6	150%	CCC+ and below CCC+	Caa1 and below Caa1	CCC+ and below CCC+