

## **Consultation Procedure**

### **Proposal for Banking Rule BR/03**

#### *Explanatory Note*

The documents circulated by the MFSA for the purpose of consultation are in draft form and consist of proposals. Accordingly these proposals are not binding and are subject to changes and revisions following representations received, inter alia, from licence-holders and other involved parties. It is important that persons involved in the consultation bear these considerations in mind.

**Note for Consultation**  
(Banking Rule BR/03)

**1. Purpose**

- 1.1 The current Banking Rule on Own Funds has been updated to be in line with the requisites of the European Union's Capital Requirements Directive 2006/48/EC – Chapter 2 – ‘Technical Instruments of Prudential Supervision’ and the Committee of European Banking Supervisors’ (CEBS) publication dated 21 December 2004, entitled ‘Guidelines on Prudential Filters for Regulatory Capital’.
- 1.2 In this respect, we are attaching a draft of the new BR/03 for consultation purposes prior to actual implementation. Comments in writing are to be provided to the MFSA by not later than 30<sup>th</sup> November 2009.

**2. Proposed amendments to Banking Rule on Own Funds (BR/03)**

2.1 The purpose of the proposed amendments to BR/03 is threefold:

- to implement Chapter 2 ‘Technical Instruments of Prudential Supervision’ of Directive 2006/48/EC. The major changes introduced include the requirement that interim net profits are to be verified by persons responsible for the auditing of the accounts (i.e. external auditors) if they are to be utilised for own funds purposes, while any participations held in insurance undertakings, reinsurance undertakings and insurance holding companies need to be deducted from own funds;
- to include innovative and non-innovative instruments (subject to a 15% limit) as part of Original Own Funds. Although presently, Directive 2006/48/EC does not cater for such instruments, the forthcoming amendments to Directive 2006/48/EC include the introduction of such instruments. These amendments have been approved and are to be transposed by 31<sup>st</sup> October 2010. In this respect, conditions listed under Item 1.1.13 ‘Innovative and Non-Innovative instruments’ in Appendix 2 of the new BR/03 are already catering for part of these changes; and
- to include prudential filters as per CEBS ‘Guidelines on Prudential Filters for Regulatory Capital’. These Guidelines had been issued as a response to the new International Financial Reporting and Accounting Standards (IFRS and IAS) rules. The objective of the prudential filters is to maintain the current definition and quality of regulatory capital.

Please do not hesitate to contact Mr Karol Gabarretta – Director (Tel: 25485174, email: [kgabarretta@mfsa.com.mt](mailto:kgabarretta@mfsa.com.mt)) or Ms Catherine Galea – S/Manager Regulation and Compliance (Tel: 25485168, email: [cgalea@mfsa.com.mt](mailto:cgalea@mfsa.com.mt)) should you have any queries or clarifications.

We thank you for your cooperation.

**Banking Unit**  
**30 October 2009**

**MFSA**

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**MALTA FINANCIAL SERVICES AUTHORITY**

**BANKING UNIT**

**BANKING RULES**

*OWN FUNDS OF CREDIT INSTITUTIONS  
AUTHORISED UNDER THE BANKING ACT 1994*

Ref: BR/03/2009

# **OWN FUNDS OF CREDIT INSTITUTIONS AUTHORISED UNDER THE BANKING ACT 1994**

## **INTRODUCTION**

1. In terms of Article 4(2) of the Banking Act 1994 ('the Act') the competent authority ('the authority') as appointed under Article 3(1) of the Act may make Banking Rules ('the Rules') as may be required for carrying into effect any of the provisions of the Act. The authority may amend or revoke such Rules. The Rules and any amendment or revocation thereof shall be officially communicated to credit institutions and the authority shall make copies thereof available to the public.
2. The Own Funds Rule ('the Rule') is being made pursuant to Article 16A(4) of the Act, which states that:

*"The competent authority shall issue a Banking Rule as it shall consider appropriate for the regulation of own funds."*

3. The Rule provides for a definition for the computation of the Own Funds of a credit institution authorised under the Act. The responsibility for observing the obligations in relation to the maintenance of Own Funds under the Act rests entirely with the credit institution's board of directors and its management.

## **SCOPE AND APPLICATION**

4. The Rule applies to all credit institutions licensed under the Act.
5. Article 7(1)(a) of the Act requires a credit institution to have initial capital<sup>1</sup> amounting to not less than five million Euro (€5,000,000) or in the case of an electronic money institution, of not less than one million Euro (€1,000,000). Such amounts may be designated in such other currency as acceptable to the authority. On the other hand, Article 16A(1) of the Act requires a credit institution to ensure that its Own Funds may not fall below the amount of initial capital established in its licence, in terms of Article 7(1)(a) or such higher amount as may be required by the authority from time to time. As required under paragraph 17 of the Application Procedures and Requirements for Authorisation of Licences for Banking Activities Rule (BR/01), Appendix 1 and 2 of this Rule also apply, as appropriate, to an applicant for a licence under the Act in fulfilling the requirements of initial capital in line with Article 7(1)(a).
6. The scope of the Rule is to standardise the requirements for the compilation of Own Funds. To achieve this scope, the Rule has been modelled on the requisites of the European Union's Capital Requirements Directive 2006/48/EC – Chapter 2 – 'Technical Instruments of Prudential Supervision', and the Committee of

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<sup>1</sup> According to Article 2(1) of the Act, "initial capital" means paid up capital and reserves as defined in a Banking Rule on own funds. Accordingly, for the purposes of this Rule, initial capital is the sum of items 1.1.5 and 1.1.12 of Appendix 1 and 2 of this Rule.

European Banking Supervisors' (CEBS) publication dated 21 December 2004, entitled 'Guidelines on Prudential Filters for Regulatory Capital'.

7. The Rule takes into account the requirements of the Act and the Companies Act (Cap. 386) which mandates compliance by all companies with International Accounting Standards (IASs) and International Financial Reporting Standards (IFRSs) as adopted by the European Union through Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 and the Commission Regulation (EC) No 1126/2008 of 3 November 2008, and any subsequent amendments thereto.
8. The Own Funds of a credit institution as calculated under this Rule shall be applied to:
  - a. the calculation of Large Exposures in accordance with the Large Exposures of Credit Institutions Rule (BR/02) as provided for under Article 16 of the Act;
  - b. the computation of Capital Requirements in accordance with the Capital Requirements of Credit Institutions Rule (BR/04) as provided under Article 17 of the Act, and the Capital Adequacy of Credit Institutions Rule (BR/08) as provided under Article 17 of the Act; and
  - c. prohibited transactions as provided under Article 15 of the Act.

#### **BRANCHES OF THIRD COUNTRY CREDIT INSTITUTIONS**

9. Paragraph 29 of BR/01 states that a licence issued to a credit institution incorporated in a third country to carry on its business of banking through a branch in Malta is deemed to having been granted to that institution as a whole and there is therefore no requirement for such a branch to have an Own Funds requirement under Article 7(1)(a) of the Act. Consequently this Rule does not apply to branches established locally of institutions from third countries.

#### **COMPONENTS OF OWN FUNDS**

10. Appendix 2 to this Rule sets out and defines the components constituting the Own Funds of a credit institution. These are divided in three categories: Original Own Funds (paid up capital, reserves, innovative & non-innovative instruments), Additional Own Funds (upper tranche and lower tranche) and Supplementary Own Funds.
11. The above three categories reflect differences in the extent to which the capital instruments concerned meet the purpose and conform to the following characteristics:
  - (i) permanence: the instrument must be permanently available so that there is no doubt that it can support depositors and other creditors in times of stress;

- (ii) loss absorption capacity: the instrument must be available to absorb losses, both on a going-concern basis and in liquidation, and to provide support for depositors' funds if necessary; and
- (iii) flexibility of on-going payments (no fixed cost): the instrument must contain features permitting the non-cumulative deferral or cancellation of payment of coupons or dividends in times of stress.

The extent to which these three criteria are fulfilled not only determines the classification of capital instruments into the different categories of regulatory Own Funds but also determines any limitations on their use.

12. For the purposes of this Rule, Original Own Funds are divided into paid up capital (item 1.1.5), reserves (item 1.1.12) and innovative & non-innovative instruments (item 1.1.13 less item 1.2.8).

Original Own Funds shall be available to a credit institution for unrestricted and immediate use to cover risks or losses as soon as these occur. The amount shall be net of any foreseeable tax charge at the moment of its calculation or be suitably adjusted in so far as such tax charges reduce the amount up to which these items may be applied to cover risks or losses.

The authority expects that paid up capital and reserves be the predominant form of a bank's Original Own Funds. They are a bank's highest quality capital, the most reliable and liquid element of a bank's capital.

Paid up capital is made up of ordinary shares, share premium accounts and perpetual non-cumulative preference shares. These shall fully absorb losses in going concern situations, and in the event of bankruptcy or liquidation shall rank after all other claims.

Innovative & non-innovative instruments are capital instruments that combine features of debt and equity but are neither considered as debt nor as equity. The term 'innovative' refers to instruments that contain specific features creating an incentive to redeem, such as a step up. (A step up is a pre-set increase at a future date in the interest rate to be paid on an innovative instrument.) Non-innovative instruments do not contain such features.

In order for an instrument to be considered an innovative or non-innovative instrument, it should meet all three criteria of permanence, loss absorption capacity and flexibility of on-going payments as per paragraph 11 above. It is to be noted that innovative instruments could incorporate certain features, such as the incentive to redeem, the effect of which is to weaken (but only marginally) the extent to which all three criteria are fulfilled.

The inclusion of innovative & non-innovative instruments in Original Own Funds is in aggregate limited to a maximum of 15% of item 1.3.7 'TOTAL Original Own Funds AFTER application of prudential filters BEFORE Other Deductions brought forward from excess in Additional Own Funds'. All innovative & non-innovative instruments shall satisfy the conditions listed under Item 1.1.13 of Appendix 2 of the Rule.

Upon publication of the Rule or any amendments thereto, reporting of any instrument previously authorised or issued which no longer qualifies under the Rule as Original Own Funds, is to be gradually reduced over a period of 30 years (grandfathering). Any redemption must be made at the initiative of the issuer and subject to prior approval by the authority.

13. Additional Own Funds consist of lower quality items than items eligible as Original Own Funds since they do not fully meet the requirements for permanence and/or absence of fixed servicing costs that apply to Original Own Funds. Similar to Original Own Funds, Additional Own Funds need to have the following characteristics:
- a. they are freely available to the credit institution to cover normal banking risks where revenue or capital losses have not yet been identified;
  - b. their existence is disclosed in internal accounting records; and
  - c. their amount is determined by the management of the credit institution, verified by independent auditors (i.e. external auditors), made known to the competent authority and placed under its supervision.

Additional Own Funds are split into ‘Upper’ and ‘Lower’ tranches depending on the extent to which the Additional Own Funds items concerned have the ability to absorb losses and provide a degree of funding flexibility to the institution.

Only perpetual capital instruments may be included in the upper tranche of Additional Own Funds. Examples of such instruments are:

- (i) perpetual cumulative preference shares;
- (ii) perpetual subordinated debt; and
- (iii) other instruments that have the same economic characteristics as (i) or (ii) above.

Additional Own Funds items which are not perpetual or which may have fixed servicing costs that cannot generally be either waived or deferred (for example, most subordinated debt) may be included in the lower tranche of Additional Own Funds. Such items should normally be of a medium to long-term maturity (that is, an original maturity of at least five years). Dated instruments are to be included in the lower tranche of Additional Own Funds.

14. Supplementary Own Funds consist of items conforming least well to the characteristics of capital listed in paragraph 11 of this Rule: either subordinated debt of short maturity or net trading book profits.

#### **CONSOLIDATED OWN FUNDS**

15. Further to the provisions of paragraph 10.0.0 of Appendix 2 of this Rule, in reporting Own Funds on a consolidated basis pursuant to the Supervision on a Consolidated Basis Rule (BR/10), credit institutions are required to determine the composition of the banking group to be consolidated in terms of paragraph 6 of the latter Rule. However, it is to be noted that according to paragraph 7 of

BR/10, the authority reserves the right to determine other undertakings not defined in paragraph 6 that could qualify for inclusion for supervision on a consolidated basis.

#### **COMPLIANCE**

16. Original Own Funds and Additional Own Funds may be used to support both banking and trading book activities under BR/04 and BR/08 respectively.
17. Supplementary Own Funds may only be used to support trading book activities as defined in BR/08.
18. Compliance with the conditions of this Rule must be proved to the satisfaction of the authority.

#### **OFFENCES AND PENALTIES**

19. Any person who commits an offence in terms of this Rule as provided for under Article 35 of the Act is liable to such penalties as may be prescribed pursuant to the said article.



## OWN FUNDS

Institution: \_\_\_\_\_

Date: \_\_\_\_\_

<b>1.0.0</b>	<b>Original Own Funds</b>	<b>€'000s</b>	<b>€'000s</b>	<b>€'000s</b>
	<b>Paid up capital</b>			
1.1.1	Ordinary shares	-		
1.1.2	Share premium account	-		
1.1.3	Perpetual non-cumulative preference shares	-		
1.1.4	Exchange rate revaluation adjustments on paid up capital	-		
<b>1.1.5</b>	<b>Total Paid Up Capital (sum of items 1.1.1 to 1.1.4)</b>		-	
	<b>Reserves</b>			
1.1.6	Retained profits/(losses)	-		
1.1.7	Interim net profits/(losses) (eligible for inclusion)	-		
1.1.8	Undistributable reserves	-		
1.1.9	Regulatory reserve	-		
1.1.10	Other reserves (specify in memorandum item 1)	-		
1.1.11	Minority interests	-		
<b>1.1.12</b>	<b>Total Reserves (sum of items 1.1.6 to 1.1.11)</b>		-	
	<b>Other instruments eligible as Original Own Funds</b>			
1.1.13	Innovative and Non-Innovative instruments (specify in memorandum item 2) (note 4)		-	
<b>1.1.14</b>	<b>Total Gross Original Own Funds (sum of items 1.1.5, 1.1.12 and 1.1.13)</b>		-	
<b>1.2.0</b>	<b>Deductions</b>			
1.2.1	Own shares	-		
1.2.2	Intangible assets (other than goodwill)	-		
1.2.3	Goodwill	-		
1.2.4	Material losses	-		
1.2.5	Shares issued by the capitalisation of property revaluation reserve	-		
1.2.6	Unrealised fair value movements, net gains/(net losses), on 'Designated at inception at fair value through the profit and loss account' financial instruments	-		
1.2.7	Net gains from capitalisation of future income from securitisations	-		
1.2.8	Excess on the limits on innovative and non-innovative instruments from Original Own Funds transferred to Additional Own Funds (note 4)	-		
1.2.9	Other Deductions (COD 10)	-		
<b>1.2.10</b>	<b>Total Deductions (sum of items 1.2.1 to 1.2.9)</b>		-	
<b>1.2.11</b>	<b>TOTAL Original Own Funds BEFORE deduction of prudential filters (item 1.1.14 less item 1.2.10)</b>		-	

<b>1.3.0</b>	<b>IFRS Prudential Filters: Deductions from Original Own Funds</b>			
1.3.1	Unrealised net losses on fair value movements on 'Designated at inception at fair value through the profit and loss account' financial instruments	-		
1.3.2	Deductions in relation to fair value movements on available for sale (AFS) financial assets			
1.3.2.1	Unrealised net losses on equity instruments classified as AFS financial assets	-		
1.3.2.2	Unrealised net losses on loans and receivables included in the AFS category	-		
1.3.2.3	Unrealised net losses on other AFS financial assets	-		
1.3.3	Deductions in relation to fair value movements on revaluation of immovable property			
1.3.3.1	Unrealised net losses on revaluation of own use property	-		
1.3.3.2	Unrealised net losses on revaluation of investment property	-		
1.3.4	Unrealised net losses reported in the hedging reserve	-		
1.3.5	Unrealised net losses reported in the currency revaluation reserve	-		
<b>1.3.6</b>	<b>Total Deductions attributable to IFRS Prudential Filters (sum of items 1.3.1 to 1.3.5)</b>		-	
<b>1.3.7</b>	<b>TOTAL Original Own Funds AFTER application of prudential filters BEFORE Other Deductions brought forward from excess in Additional Own Funds (item 1.2.11 less item 1.3.6)</b>		-	
<b>1.3.8</b>	<b>Other Deductions brought forward from excess in Additional Own Funds (note 6)</b>		-	
<b>1.4.0</b>	<b>TOTAL Original Own Funds AFTER application of prudential filters and AFTER Other Deductions brought forward from excess in Additional Own Funds (item 1.3.7 less item 1.3.8)</b>			-

2.0.0	Additional Own Funds	€'000s	€'000s	€'000s
	<b>Upper tranche</b>			
2.1.1	Perpetual securities	-		
2.1.2	Shares issued by the capitalisation of property revaluation reserves	-		
2.1.3	Excess on limits on innovative and non-innovative instruments from Original Own Funds transferred to Additional Own Funds (note 4)	-		
2.1.4	Minority interests	-		
<b>2.1.5</b>	<b>Total Upper Tranche Additional Own Funds (sum of items 2.1.1 to 2.1.4)</b>		-	
	<b>Lower tranche</b>			
2.1.6	Fixed term preference shares	-		
2.1.7	Subordinated loan capital	-		
2.1.8	Excess of provisions over the expected loss amounts calculated by institutions utilising the IRB approach	-		
2.1.9	Collective provisioning	-		
2.1.10	Minority interests	-		
<b>2.1.11</b>	<b>Total Lower Tranche Additional Own Funds (sum of items 2.1.6 to 2.1.10)</b>		-	
<b>2.2.0</b>	<b>Deductions</b>			
2.2.1	Excess of the limits of the lower tranche of the Additional Own Funds (note 1)	-		
2.2.2	Other Deductions (note 6)	-		
<b>2.2.3</b>	<b>Total Deductions (sum of items 2.2.1 and 2.2.2)</b>		-	
<b>2.2.4</b>	<b>TOTAL Additional Own Funds BEFORE the application of prudential filters (sum of items 2.1.5 and 2.1.11, less item 2.2.3)</b>		-	
<b>2.3.0</b>	<b>IFRS Prudential Filters: Increases to Additional Own Funds</b>			
2.3.1	Unrealised net gains on fair value movements on 'Designated at inception at fair value through the profit and loss account' financial instruments	-		
2.3.2	Additions in relation to fair value movements on AFS financial assets			
2.3.2.1	Unrealised net gains on equity instruments classified as AFS financial assets	-		
2.3.2.2	Unrealised net gains on loans and receivables included in the AFS category	-		
2.3.2.3	Unrealised net gains on other AFS financial assets	-		
2.3.3	Additions in relation to fair value movements on revaluation of immovable property			
2.3.3.1	Unrealised net gains on revaluation of own use property	-		
2.3.3.2	Unrealised net gains on revaluation of investment property	-		
2.3.4	Unrealised net gains reported in the hedging reserve	-		
2.3.5	Unrealised net gains reported in the currency revaluation reserve	-		
<b>2.3.6</b>	<b>Total Increase attributable to IFRS Prudential Filters (sum of items 2.3.1 to 2.3.5)</b>		-	
<b>2.4.0</b>	<b>TOTAL Additional Own Funds AFTER application of prudential filters (sum of items 2.2.4 and 2.3.6)</b>		-	
<b>2.5.0</b>	<b>Deduction</b>			
2.5.1	Excess of limits of Additional Own Funds (note 2)		-	
<b>2.6.0</b>	<b>TOTAL Eligible Additional Own Funds (item 2.4.0 less item 2.5.1)</b>			-
<b>3.0.0</b>	<b>TOTAL Gross Own Funds (sum of items 1.4.0 and 2.6.0)</b>			-

4.0.0	Supplementary Own Funds	€'000s	€'000s	€'000s
4.1.0	Subordinated loan capital (note 3)	-		
4.2.0	Net trading book profits/(losses)	-		
<b>4.3.0</b>	<b>TOTAL Supplementary Own Funds (sum of items 4.1.0 and 4.2.0) (note 5)</b>			-
<b>5.0.0</b>	<b>TOTAL OWN FUNDS (sum of items 3.0.0 and 4.3.0)</b>			-
<b>6.0.0</b>	<b>TOTAL Own Funds for the purposes of 'LARGE EXPOSURES' (item 3.0.0 less item 2.1.8 plus COD 7 and COD 8)</b>			-
<b>7.0.0</b>	<b>TOTAL Own Funds for the purposes of 'QUALIFYING HOLDINGS OUTSIDE THE FINANCIAL SECTOR' (item 3.0.0 less item 2.1.8 plus COD 3, COD 7 and COD 8)</b>			-
<b>8.0.0</b>	<b>TOTAL Own Funds for the purposes of COD 2 (sum of items 3.0.0, COD 1, 4 and 5)</b>			-
	<b>CALCULATION OF OTHER DEDUCTIONS</b>	€'000s	€'000s	€'000s
COD 1	Holdings in other credit and/or financial institutions amounting to more than 10% of the investee institutions' capital. Itemise below:		-	
COD 1.1		-		
COD 1.2		-		
COD 1.3		-		
COD 1.4		-		
COD 1.5		-		
COD 2	Aggregate holdings in other credit and/or financial institutions of up to 10% of their capital and instruments which the credit institution holds in such institutions which are eligible as own funds (other than those included in COD 1) which in aggregate exceed 10% of item 8.0.0. Itemise below:		-	
COD 2.1		-		
COD 2.2		-		
COD 2.3		-		
COD 2.4		-		
COD 2.5		-		
COD 3	Shareholding in a company other than a credit and/or financial institution which is not supervised on a consolidated basis. (The 15% and 60% shall be calculated on the basis of Item 7.0.0). Itemise below:		-	
COD 3.1		-		
COD 3.2		-		
COD 3.3		-		
COD 3.4		-		
COD 3.5		-		
COD 4	Participations held in insurance undertakings, reinsurance undertakings and insurance holding companies. Itemise below:		-	
COD 4.1		-		
COD 4.2		-		
COD 4.3		-		
COD 4.4		-		
COD 4.5		-		

COD 5	Other instruments held in respect of insurance undertakings, reinsurance undertakings and insurance holding companies in which a participation is maintained. Itemise below:			
COD 5.1		-		
COD 5.2		-		
COD 5.3		-		
COD 5.4		-		
COD 5.5		-		
COD 6	Deduction in line with the First schedule of the Financial Conglomerates Regulation		-	
COD 7	Securitisation exposures not included in risk-weighted assets		-	
COD 8	The expected loss amount calculated using the Internal Ratings Based approach of the Capital Requirements Rule (excess over specific provisions)		-	
<b>COD 9</b>	<b>Total other deductions (sum of COD 1 to COD 8)</b>		<b>-</b>	
<b>COD 10</b>	<b>Half total other deductions ( half COD 9 for the purposes of note 6)</b>		<b>-</b>	

**Memorandum item 1:**

1.1.10	Itemise any entry reported under item 1.1.10 'Other Reserves'

**Memorandum item 2:**

1.1.13	Itemise and describe instruments being reported under item 1.1.13 'Innovative and Non-Innovative Instruments'

**Notes:**

- (1) The amount of the items which may be included in the 'Lower Tranche' of the 'Additional Own Funds' must not exceed 50% of Item 1.3.7 'TOTAL Original Own Funds AFTER application of prudential filters BEFORE Other Deductions brought forward from excess in Additional Own Funds' (item 1.2.11 less item 1.3.6) Any amount in excess of 50% of Item 1.3.7 is being computed automatically in the cell of item 2.2.1 and deducted from the 'Lower Tranche' of the 'Additional Own Funds'.
- (2) Item 2.6.0 'TOTAL Eligible Additional Own Funds' shall not exceed item 1.4.0 'TOTAL Original Own Funds AFTER application of prudential filters and AFTER Other Deductions brought forward from excess in Additional Own Funds'. Any amount in excess of Item 1.4.0 is being computed automatically in the cell of item 2.5.1 and deducted from item 2.4.0 'TOTAL Additional Own Funds AFTER application of prudential filters'.
- (3) Item 2.6.0 'TOTAL Eligible Additional Own Funds' and item 4.1.0 'Subordinated loan capital' used to meet the trading book capital requirements must not in total exceed 150% of item 1.4.0 'TOTAL Original Own Funds AFTER application of prudential filters and AFTER Other Deductions brought forward from excess in Additional Own Funds' left to meet trading book activities and foreign exchange risk.
- (4) Report **all** Innovative & Non-Innovative Instruments under Item 1.1.13 'Innovative and Non-Innovative Instruments'. No more than 15% of Item 1.3.7 'TOTAL Original Own Funds AFTER application of prudential filters BEFORE Other Deductions brought forward from excess in Additional Own Funds' shall consist of Innovative and Non-innovative instruments. The deduction of Item 1.2.8 from Item 1.1.14 will help achieve the 15% limit. The excess of Innovative and Non-Innovative Instruments over the 15% limit shall be transferred to Additional Own Funds through Item 2.1.3. Item 2.1.3 shall be equal to Item 1.2.8. Formulas have been integrated in the cells for items 1.2.8 and 2.1.3.
- (5) At overall consolidated group level or at solo level if the credit institution is not part of a consolidated group, the sum of item 2.6.0 'TOTAL Eligible Additional Own Funds' and Item 4.3.0 'TOTAL Supplementary Own Funds' cannot exceed 100% of the credit institution / group item 1.4.0 'TOTAL Original Own Funds AFTER application of prudential filters and AFTER Other Deductions brought forward from excess in Additional Own Funds'.
- (6) COD 10 shall be included as a deduction in both Item 1.2.9 'Other Deductions' that is being reported under Item 1.2.0 'Deductions' and as a deduction in Item 2.2.2 'Other Deductions' that is being reported under Item 2.2.0 'Deductions'. To the extent that Item 2.2.2 exceeds the sum of items 2.1.5 and 2.1.11 less item 2.2.1 the excess shall be computed automatically in the cell of item 1.3.8 and deducted from item 1.3.7. COD 7 shall not be deducted if it has been included in the calculation of risk-weighted exposure amounts for the purposes of Appendix 1 of BR/04 and as specified in Appendix 3 section 1.4 of the same rule.

**OWN FUNDS****1.0.0 ORIGINAL OWN FUNDS****PAID UP CAPITAL****1.1.1 Ordinary shares**

The nominal paid-up value of the share capital shall be reported. The unpaid element of partly-paid shares or authorised but unissued share capital is not to be reported. Where shares have been issued at a premium, the premium should be reported separately under item 1.1.2 'Share premium account'. Should the base currency differ from the reporting currency, institutions are requested to convert the ordinary share capital from the functional (base) currency to the reporting currency using the historical rate as required by the authority.

The ordinary shares to be reported under this item are to fully absorb losses in going concern situations, and in the event of bankruptcy or liquidation rank after all other claims.

**1.1.2 Share premium account**

Report any amount received in excess of the nominal value of any shares issued by the credit institution.

**1.1.3 Perpetual non-cumulative preference shares**

Only perpetual (non-redeemable) non-cumulative preference shares which have been issued and paid up, are to be reported. These shares are to fully absorb losses in going concern situations, and in the event of bankruptcy or liquidation rank after all other claims.

**1.1.4 Exchange rate revaluation adjustments on paid up capital**

This item shall comprise movements which are being reflected in the foreign exchange value of a currency upon conversion of the paid up capital (items 1.1.1 to 1.1.3) from the institution's functional (base) currency to the reporting currency.

**1.1.5 Total Paid Up Capital (sum of items 1.1.1 to 1.1.4)**

This sum is computed automatically.

**RESERVES****1.1.6 Retained profits/(losses)**

Report the balance of retained earnings which is available for distribution to the shareholders. Retained losses (debit balance) must be included as a negative amount. Any balance reported should be net of any foreseeable dividends.

**1.1.7 Interim net profits/(losses) (eligible for inclusion)**

Report interim net profits after deduction of any foreseeable charge, tax or dividend. A credit institution may include interim net profits before a formal decision has been taken only if these profits have been verified by persons

responsible for the auditing of the accounts (i.e. external auditors) and if it is proved to the satisfaction of the authority that the amount thereof has been evaluated in accordance with IFRS's as adopted by the EU. ***Net profits should be inserted as a positive figure, while net losses must be inserted as a negative figure.***

#### **1.1.8 Undistributable reserves**

Report any funds set aside for specific purposes, and which cannot be made available for distribution.

#### **1.1.9 Regulatory reserve**

Report any funds that the institution may want to set aside over and above the requirements of specific and collective provisions.

#### **1.1.10 Other reserves**

(specify in memorandum item 1)

This item shall comprise any other reserves not reported elsewhere in the Own Funds computation. A breakdown of this item is to be included as a memorandum item. This reserve shall not include any revaluation reserves and/or hedging reserves. Any reserves set aside for the Deposit Compensation Scheme should not be included in the own funds computation.

#### **1.1.11 Minority interests**

Where the global integration method is used, to include any minority interests where the amount attributable to shares in subsidiary undertakings included in the consolidation is held by persons other than the undertakings included in the consolidation. This item shall only apply for consolidation purposes.

#### **1.1.12 Total Reserves (sum of items 1.1.6 to 1.1.11)**

This sum is computed automatically.

### **OTHER INSTRUMENTS ELIGIBLE AS ORIGINAL OWN FUNDS**

#### **1.1.13 Innovative and Non-Innovative Instruments**

(specify in memorandum item 2)

Report the full value of all Instruments other than items 1.1.1 to 1.1.3 that fulfill the following conditions:

- [i] they may not be reimbursed on the bearer's initiative or without the prior agreement of the authority;
- [ii] the lender's claims on the credit institution must be wholly subordinated to those of all non-subordinated creditors;
- [iii] the documents governing the issue of the securities shall provide for debt and unpaid interest to be such as to absorb losses, whilst leaving the credit institution in a position to continue trading;
- [iv] only fully paid-up amounts shall be taken into account;



- [v] The instruments shall be undated or have an original maturity of at least 30 years. Those instruments may include one or more call options at the sole discretion of the issuer, but they shall not be redeemed before five years after the date of issue. If the statutory or contractual provisions governing undated instruments provide for a moderate incentive (step up) for the credit institution to redeem as determined by the authority, such incentive shall not occur before ten years after the date of issue. The statutory or contractual provisions governing dated instruments shall not allow for any incentive to redeem other than the maturity date.

Dated and undated instruments may be called or redeemed only with the prior consent of the authority and under the condition that they will be replaced by items of same or better quality. The authority may waive the condition and still grant permission, provided the request is made at the initiative of the credit institution, and either financial or solvency conditions of the credit institution are not unduly affected.

The authority shall require the suspension of the redemption for dated instruments if the credit institution does not comply with Articles 16A and 17D of the Act, BR/04, BR/08 and the Banking Rule on the Supervisory Review Process (BR/12) and may require the suspension of the redemption at other times based on the financial and solvency situation of credit institutions.

The authority may grant permission at any time for an early redemption of dated and undated instruments in the event that there is a change in the applicable tax treatment or regulatory classification of such instruments which was unforeseen at the date of issue;

- [vi] The statutory or contractual provisions governing the instrument shall allow the credit institution to cancel, when necessary, the payment of interest or dividends for an unlimited period of time, on a non-cumulative basis. However, the credit institution shall cancel such payments if it does not comply with Articles 16A and 17D of the Act, BR/04, BR/08 and BR/12.

The authority may require the cancellation of such payments based on the financial and solvency situation of the credit institution. Such cancellation shall not prejudice the right of the credit institution to substitute the payment of interest or dividend by a payment in the form of an instrument referred to in items 1.1.1 to 1.1.3, provided that any such mechanism allows the credit institution to preserve financial resources. Such substitution may be subject to specific conditions established by the authority; and

- [vii] The statutory or contractual provisions governing the instrument shall provide for principal, unpaid interest or dividend to be such as to absorb losses and to not hinder the recapitalisation of the credit institution.

[viii] In the event of the bankruptcy or liquidation of the credit institution, the instruments shall rank after item 2.1.1 of Appendix 1 & 2 of the Rule.

**1.1.14 Total Gross Original Own Funds (sum of items 1.1.5, 1.1.12 and 1.1.13)**

This sum is computed automatically.

**1.2.0 DEDUCTIONS**

**1.2.1 Own shares**

Report own shares held at book value<sup>1</sup> by the credit institution.

**1.2.2 Intangible assets (other than goodwill)**

Report any intangible assets (other than goodwill) including copyrights, patents, intellectual property.

**1.2.3 Goodwill**

Report any goodwill arising on consolidation which represents the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities exceeding cost.

**1.2.4 Material losses**

Report any material losses incurred during the current financial year and not included under item 1.1.7.

**1.2.5 Shares issued by the capitalisation of property revaluation reserve**

Report all shares issued by the capitalisation of property revaluation reserves.

**1.2.6 Unrealised fair value movements, net gains/(net losses), on 'Designated at inception at fair value through the profit and loss account' financial instruments**

Report any unrealised fair value movements (including both unrealised gains and losses) on 'Designated at inception at fair value through the profit and loss account' financial instruments. *The resulting net gains should be deducted and the resulting net losses should be added back to neutralise their effect on the income statement as included under items 1.1.6 and 1.1.7. Net gains should be inserted as a positive figure, while net losses must be inserted as a negative figure.*

**1.2.7 Net gains from capitalisation of future income from securitisations**

Where a credit institution is the originator of a securitisation transaction, the said institution is to report any net gains arising from the capitalisation of future income from the securitised asset/s, together with any unrealised fair value movements that might take place. This does not include any residuary income.

**1.2.8 Excess on the limits on innovative and non-innovative instruments from Original Own Funds transferred to Additional Own Funds**

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<sup>1</sup> For the purposes of this Rule, the term 'book value' shall be construed to mean the value depicted in the balance sheet.

Vide note (4) in Appendix 1. Report the amount of innovative and non-innovative instruments over and above the limit of 15% of item 1.3.7 'TOTAL Original Own Funds AFTER application of prudential filters BEFORE Other Deductions brought forward from excess in Additional Own Funds'. This calculation is computed automatically.<sup>2</sup>

### **1.2.9 Other Deductions**

Vide note (6) in Appendix 1. This item is equal to COD 10 and is computed automatically.

### **1.2.10 Total Deductions (sum of items 1.2.1 to 1.2.9)**

The sum of the Deductions is computed automatically.

### **1.2.11 TOTAL Original Own Funds BEFORE deduction of prudential filters**

Item 1.1.14 'Total Gross Original Own Funds' less item 1.2.10 'Total Deductions' represents 'TOTAL Original Own Funds BEFORE deduction of prudential filters'. This calculation is computed automatically.

## **1.3.0 IFRS PRUDENTIAL FILTERS: DEDUCTIONS FROM ORIGINAL OWN FUNDS**

### **1.3.1 Unrealised net losses on fair value movements on 'Designated at inception at fair value through the profit and loss account' financial instruments**

Report any unrealised net losses on fair value movements on 'Designated at inception at fair value through the profit and loss account' financial instruments reported under item 1.2.6. This item is computed automatically.

### **1.3.2 Deductions in relation to fair value movements on available for sale (AFS) financial assets**

#### ***1.3.2.1 Unrealised net losses on equity instruments classified as AFS financial assets***

*Report any unrealised net losses on equity instruments classified as AFS.*

#### ***1.3.2.2 Unrealised net losses on loans and receivables included in the AFS category***

*Report any unrealised net losses on loans and receivables included in the AFS category apart from those related to impairment.*

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<sup>2</sup> (1)The figure for item 1.3.7 'TOTAL Original Own Funds AFTER application of prudential filters BEFORE Other Deductions brought forward from excess in Additional Own Funds' is calculated without taking into consideration item 1.1.13 'Innovative and Non-Innovative instruments' and item 1.2.8 'Excess on the limits on innovative and non-innovative instruments from Original Own Funds transferred to Additional Own Funds'.

(2) Given that the limit for innovative and non-innovative instruments is 15% of item 1.3.7 which includes the 15% of innovative & non-innovative instruments, the figure arrived to in (1) above should at a minimum represent 85% of item 1.3.7 when including 15% innovative and non-innovative instruments. Consequently by calculating 17.65% of the figure found in (1) it is possible to arrive to the limit of 15% that is eligible for inclusion in Original Own Funds.

(3)The figure found in (2) is deducted from the figure reported in item 1.1.13. The result shall be the figure to be reported under item 1.2.8 and thus deducted from Original Own Funds.

**1.3.2.3 Unrealised net losses on other AFS financial assets**

*Report any other unrealised net losses on any other instruments classified as AFS not captured in items 1.3.2.1 and 1.3.2.2.*

**1.3.3 Deductions in relation to fair value movements on revaluation of immovable property****1.3.3.1 Unrealised net losses on revaluation of own use property**

*Report any unrealised net losses on revaluation of own use immovable property not included under items 1.1.6 and 1.1.7.*

**1.3.3.2 Unrealised net losses on revaluation of investment property**

*Report any unrealised net losses on revaluation of investment property (in line with the requirements of IAS 40, however within the limits specified in Article 15(1)(f) of the Act) not included under items 1.1.6 and 1.1.7.*

**1.3.4 Unrealised net losses reported in the hedging reserve**

Report any unrealised net losses which are being reflected in the hedging reserve. There should be a consistent treatment of gains and losses resulting from a transaction whereby a cash flow hedge is created for an available for sale instrument: i.e. if the gains of the hedged item are recognised in additional own funds, so should the results of the corresponding cash flow hedge.

Credit institutions shall not include in Own Funds either the fair value reserves related to losses on cash flow hedges on financial instruments measured at amortised cost, or any losses on their liabilities valued at fair value that are due to changes in the credit institutions' own credit standing.

**1.3.5 Unrealised net losses reported in the currency revaluation reserve**

Report any unrealised net losses which are being reflected in the currency revaluation reserve other than that depicted in item 1.1.4.

**1.3.6 Total Deductions attributable to IFRS Prudential Filters (sum of items 1.3.1 to 1.3.5)**

The sum of the Deductions is computed automatically.

**1.3.7 TOTAL Original Own Funds AFTER application of prudential filters BEFORE Other Deductions brought forward from excess in Additional Own Funds (item 1.2.11 less item 1.3.6)**

This calculation is computed automatically.

**1.3.8 Other Deductions brought forward from excess in Additional Own Funds**

Vide note (6) in Appendix 1. Should COD 10 'Half total other deductions' exceed the sum of items 2.1.5 'Total Upper Tranche Additional Own Funds' and 2.1.11 'Total Lower Tranche Additional Own Funds' less item 2.2.1 'Excess of the limits of the lower tranche of the Additional Own Funds', the excess shall be computed automatically.

**1.4.0 TOTAL Original Own Funds AFTER application of prudential filters and AFTER Other Deductions brought forward from excess in Additional Own Funds**

Item 1.3.7 'TOTAL Original Own Funds AFTER application of prudential filters BEFORE Other Deductions brought forward from excess in Additional Own Funds' less item 1.3.8 'Other Deductions brought forward from excess in Additional Own Funds' represents 'TOTAL Original Own Funds AFTER application of prudential filters and AFTER Other Deductions brought forward from excess in Additional Own Funds'. The result of the above calculation shall be computed automatically.

## **2.0.0 ADDITIONAL OWN FUNDS**

### **UPPER TRANCHE**

#### **2.1.1 Perpetual securities**

Report securities and other instruments of indeterminate duration that fulfill the following conditions:

- [a] they may not be reimbursed on the bearer's initiative or without the prior agreement of the authority;
- [b] the debt agreement must provide for the credit institution to have the option of deferring the payment of interest on the debt;
- [c] the lender's claims on the credit institution must be wholly subordinated to those of all non-subordinated creditors;
- [d] the documents governing the issue of the securities must provide for debt and unpaid interest to be such as to absorb losses, whilst leaving the credit institution in a position to continue trading; and
- [e] only fully paid-up amounts shall be taken into account.

Perpetual cumulative preference shares are included under this item.

#### **2.1.2 Shares issued by the capitalisation of property revaluation reserves**

Report the amount deducted under item 1.2.5. This amount is computed automatically.

#### **2.1.3 Excess on limits on innovative and non-innovative instruments from Original Own Funds transferred to Additional Own Funds**

Vide note (4) in Appendix 1. Report the amount over and above the limit of 15% set on innovative and non-innovative instruments which has already been deducted from Original Own Funds through item 1.2.8 above. This item is computed automatically.

#### **2.1.4 Minority interests**

Where the global integration method is used, to include any minority interests where the amount attributable to outside interests reported in capital items forming part of the 'Upper tranche' of 'Additional Own Funds' of subsidiary undertakings included in the consolidation is held by persons other than the undertakings included in the consolidation. This item shall only apply for consolidation purposes.

**2.1.5 Total Upper Tranche Additional Own Funds (sum of items 2.1.1 to 2.1.4)**  
This sum is computed automatically.

**LOWER TRANCHE**

**2.1.6 Fixed term preference shares**

Report any fixed term cumulative and non-cumulative preference shares if binding agreements exist under which, in the event of the bankruptcy or liquidation of the credit institution, they rank after the claims of all other creditors and are not to be repaid until all other debts outstanding at the time have been settled. The extent to which fixed term preference shares may rank as Own Funds must be proportionately reduced (on a quarterly basis) during, at least, the last five years before the repayment date.

**2.1.7 Subordinated loan capital**

Report subordinated loan capital if the following conditions are fulfilled:

- [a] if binding agreements exist under which, in the event of the bankruptcy or liquidation of the credit institution, they rank after the claims of all other creditors and are not to be repaid until all other debts outstanding at the time have been settled;
- [b] only fully paid-up funds may be taken into account;
- [c] the loans involved must have an original maturity of at least five years, after which they may be repaid; if the maturity of the debt is not fixed, they shall be repayable only subject to five years' notice unless the loans are no longer considered as Own Funds or unless the prior consent of the authority is specifically required for early repayment. The permission for the early repayment of such loans may only be granted provided that the request is made at the initiative of the issuer and the solvency of the credit institution in question is not affected;
- [d] the extent to which they may rank as Own Funds must be proportionately reduced (on a quarterly basis) during, at least, the last five years before the repayment date; and
- [e] the loan agreement must not include any clause providing that in specified circumstances, other than the winding up of the credit institution, the debt will become repayable before the agreed repayment date.

**2.1.8 Excess of provisions over the expected loss amounts calculated by institutions utilising the IRB approach**

Credit institutions calculating their credit risk requirement using the IRB approach, may include the positive amounts resulting from the calculation in Appendix 2, Section II.2, Paragraph 4.1.0 of BR/04 *'Treatment of Expected Loss Amounts'* up to a limit of 0.6% of risk weighted assets. This calculation measures the excess of value adjustments and provisions over expected loss amounts.

For these credit institutions value adjustments and provisions included in the calculation referred to in Appendix 2, Section II.2, Paragraph 4.1.0 of BR/04 and value adjustments and provisions for exposures referred to in *point (e) of Article 57* of the EU Directive 2006/48/EC shall not be included in Own Funds other than in accordance with this provision.

For these purposes, risk-weighted exposure amounts shall not include those calculated in respect of securitisation positions which have a higher risk weight of 1250%.

### **2.1.9 Collective provisioning**

Report the amount of collective provisions, that are not being deducted directly from the book value<sup>1</sup> of assets prior to the application of the risk weight for capital requirements purposes.

### **2.1.10 Minority interests**

Where the global integration method is used, to include any minority interests where the amount attributable to outside interests reported in items forming part of the 'Lower tranche' of 'Additional Own Funds' of subsidiary undertakings included in the consolidation is held by persons other than the undertakings included in the consolidation. This item shall only apply for consolidation purposes.

### **2.1.11 Total Lower Tranche Additional Own Funds (sum of items 2.1.6 to 2.1.10)**

This sum is computed automatically.

## **2.2.0 DEDUCTIONS**

### **2.2.1 Excess of the limits of the lower tranche of the Additional Own Funds**

Report the amount in item 2.1.11 'Total Lower Tranche Additional Own Funds' which exceeds 50% of the amount in item 1.3.7 'TOTAL Original Own Funds AFTER application of prudential filters BEFORE Other Deductions brought forward from excess in Additional Own Funds' as stipulated in Note 1 of Appendix 1. This amount is computed automatically.

### **2.2.2 Other Deductions**

Vide note (6) in Appendix 1. Should COD 10 'Half total other deductions' exceed the sum of items 2.1.5 and 2.1.11 less item 2.2.1, the excess shall be reported under item 1.3.8. This amount is computed automatically.

### **2.2.3 Total Deductions (sum of items 2.2.1 and 2.2.2)**

The sum of the Deductions is computed automatically.

### **2.2.4 TOTAL Additional Own Funds BEFORE the application of prudential filters**

Report the total of item 2.1.5 'Total Upper Tranche Additional Own Funds' and item 2.1.11 'Total Lower Tranche Additional Own Funds' less item 2.2.3 'Total Deductions'. This amount is computed automatically.

### 2.3.0 IFRS PRUDENTIAL FILTERS: INCREASES TO ADDITIONAL OWN FUNDS

#### 2.3.1 Unrealised net gains on fair value movements on 'Designated at inception at fair value through the profit and loss account' financial instruments

Report any unrealised net gains on fair value movements 'Designated at inception at fair value through the profit and loss account' financial instruments reported under item 1.2.6. This figure should be net of any foreseeable tax and charges. This amount is computed automatically.

#### 2.3.2 Additions in relation to fair value movements on AFS financial assets

##### 2.3.2.1 *Unrealised net gains on equity instruments classified as AFS financial assets*

Report **up to 65%**<sup>3</sup> of the unrealised net gains on equity instruments classified as AFS.

##### 2.3.2.2 *Unrealised net gains on loans and receivables included in the AFS category*

Report **up to 65%**<sup>3</sup> of the unrealised net gains on loans and receivables included in the AFS category apart from those related to impairment.

##### 2.3.2.3 *Unrealised net gains on other AFS financial assets*

Report **up to 65%**<sup>3</sup> of any other unrealised net gains on any other instruments classified as AFS not captured in items 2.3.2.1 and 2.3.2.2.

#### 2.3.3 Additions in relation to fair value movements on revaluation of immovable property

##### 2.3.3.1 *Unrealised net gains on revaluation of own use property*

Report **up to 65%**<sup>3</sup> on any unrealised net gains on revaluation of own use immovable property not included under items 1.1.6 and 1.1.7.

##### 2.3.3.2 *Unrealised net gains on revaluation of investment property*

Report **up to 65%**<sup>3</sup> of any unrealised net gains on revaluation of investment property (in line with the requirements of IAS 40, however within the limits specified in Article 15(1)(f) of the Act) not included under items 1.1.6 and 1.1.7.

#### 2.3.4 Unrealised net gains reported in the hedging reserve

Report **up to 65%**<sup>3</sup> of any unrealised net gains which are being reflected in the hedging reserve. There should be a consistent treatment of gains and losses resulting from a transaction whereby a cash flow hedge is created for an available for sale instrument: i.e. if the gains of the hedged item are recognised in additional own funds, so should the results of the corresponding cash flow hedge.

Credit institutions shall not include in Own Funds either the fair value reserves related to gains on cash flow hedges on financial instruments measured at amortised cost, or any gains on their liabilities valued at fair value that are due to changes in the credit institutions' own credit standing.

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<sup>3</sup> After taking into effect the foreseeable tax element of 35%.



**2.3.5 Unrealised net gains reported in the currency revaluation reserve**  
Report **up to 65%**<sup>3</sup> of unrealised net gains which are being reflected in the currency revaluation reserve other than that depicted in item 1.1.4.

**2.3.6 Total Increase attributable to IFRS Prudential Filters (sum of items 2.3.1 to 2.3.5)**

This sum is computed automatically.

**2.4.0 TOTAL Additional Own Funds AFTER application of prudential filters**  
Report the total of item 2.2.4 'TOTAL Additional Own Funds BEFORE the application of prudential filters' and item 2.3.6 'Total Increase attributable to IFRS Prudential Filters'. This sum is computed automatically.

Credit institutions shall not include in Own Funds the fair value reserves relating to gains or losses on their liabilities valued at fair value that are due to changes in the credit institutions' own credit standing.

**2.5.0 DEDUCTION**

**2.5.1 Excess of limits of Additional Own Funds**

Report the amount in item 2.4.0 'TOTAL Additional Own Funds AFTER application of prudential filters' which is in excess of the amount in item 1.4.0 'TOTAL Original Own Funds AFTER application of prudential filters and AFTER Other Deductions brought forward from excess in Additional Own Funds' as stipulated in Note 2 of Appendix 1. This amount is computed automatically.

**2.6.0 TOTAL Eligible Additional Own Funds**

Item 2.4.0 'TOTAL Additional Own Funds AFTER application of prudential filters' less item 2.5.1 'Excess of limits of Additional Own Funds' represents 'TOTAL Eligible Additional Own Funds'. This deduction is computed automatically.

**3.0.0 TOTAL Gross Own Funds**

The total of items 1.4.0 'TOTAL Original Own Funds AFTER application of prudential filters and AFTER Other Deductions brought forward from excess in Additional Own Funds' and item 2.6.0 'TOTAL Eligible Additional Own Funds' represent 'Total Gross Own Funds'. This sum is computed automatically. This item represents 'Total Own Funds' for those credit institutions which are exempted from the trading book requirements under the Capital Adequacy Rule BR/08.

**4.0.0 SUPPLEMENTARY OWN FUNDS**

**4.1.0 Subordinated loan capital**

Vide note (3) in Appendix 1. Report subordinated loan capital if the following conditions are fulfilled:

- [a] if binding agreements exist under which, in the event of the bankruptcy or liquidation of the credit institution, they rank after the claims of all other creditors and are not to be repaid until all other debts outstanding at the time have been settled;
- [b] only fully paid-up funds may be taken into account;
- [c] the loans involved must have an original maturity of at least two years, after which they may be repaid; if the maturity of the debt is not fixed, they shall be repayable only subject to two years' notice unless the loans are no longer considered as Own Funds or unless the prior consent of the authority is specifically required for early repayment. The permission for the early repayment of such loans may only be granted provided that the request is made at the initiative of the issuer and the solvency of the credit institution in question is not affected;
- [d] the extent to which they may rank as Own Funds must be proportionately reduced during, at least, the last two years before the repayment date; and
- [e] the loan agreement must not include any clause providing that in specified circumstances, other than the winding up of the credit institution, the debt will become repayable before the agreed repayment date.

#### **4.2.0 Net trading book profits/(losses)**

Net trading book profits/(losses) after deduction of any foreseeable charge, tax or dividend provided that none of this amount has already been included in item 1.1.6 'Retained profits/(losses)', item 1.1.7 'Interim net profits/(losses)' and item 1.2.4 'Material Losses' of this Rule. The authority must be satisfied that these trading book profits/(losses) have been calculated using appropriate techniques.

#### **4.3.0 TOTAL Supplementary Own Funds**

Vide note (5) in Appendix 1. The total of items 4.1.0 'Subordinated loan capital' and item 4.2.0 'Net trading book profits/(losses)' represent the 'TOTAL Supplementary Own Funds'. This sum is computed automatically.

#### **5.0.0 TOTAL OWN FUNDS (sum of items 3.0.0 and 4.3.0)**

This item represents 'Total Own Funds' for those credit institutions which are *not* exempt from the trading book requirements and therefore subject to the Capital Adequacy Rule BR/08. This sum is computed automatically.

#### **6.0.0 TOTAL Own Funds for the purposes of 'LARGE EXPOSURES' (item 3.0.0 less item 2.1.8 plus COD 7 and COD 8)**

For the purposes of 'Large Exposures' item 4.3.0 'TOTAL Supplementary Own Funds', item 2.1.8 'Excess of provisions over the expected loss amounts calculated by institutions utilising the IRB approach', COD 7 'Securitisation exposures not included in risk-weighted assets' and COD 8 'The expected loss amount calculated using the Internal Ratings Based approach of the Capital Requirements Rule (excess over specific provisions)' shall not be taken into account. This amount is computed automatically.

**7.0.0 TOTAL Own Funds for the purposes of ‘QUALIFYING HOLDINGS OUTSIDE THE FINANCIAL SECTOR’ (item 3.0.0 less item 2.1.8 plus COD 3, COD 7 and COD 8)**

For the purposes of ‘Qualifying Holdings outside the Financial Sector’ item 4.3.0 ‘TOTAL Supplementary Own Funds’, item 2.1.8 ‘Excess of provisions over the expected loss amounts calculated by institutions utilising the IRB approach’, COD 3 ‘Shareholding in a company other than a credit and/or financial institution which is not supervised on a consolidated basis’, COD 7 ‘Securitisation exposures not included in risk-weighted assets’ and COD 8 ‘The expected loss amount calculated using the Internal Ratings Based approach of the Capital Requirements Rule (excess over specific provisions)’ shall not be taken into account. This amount is computed automatically.

**8.0.0 TOTAL Own Funds for the purposes of COD 2 (sum of items 3.0.0, COD 1, COD 4 and COD 5)**

TOTAL Own Funds for the purposes of COD 2 shall not take into account item 4.3.0 ‘TOTAL Supplementary Own Funds’, COD 1 ‘Holdings in other credit and/or financial institutions amounting to more than 10% of the investee institutions capital’, COD 4 ‘Participations held in insurance undertakings, reinsurance undertakings and insurance holding companies’ and COD 5 ‘Other instruments held in respect of insurance undertakings, reinsurance undertakings and insurance holding companies in which a participation is maintained’. This amount is computed automatically.

**CALCULATION OF OTHER DEDUCTIONS**

**COD 1. Holdings in other credit and/or financial institutions amounting to more than 10% of the investee institutions’ capital**

When the credit institution holds more than 10% of the capital<sup>4</sup> of another credit institution and/or financial institution, for each holding, the following shall be deducted as per note (6) of Appendix 1:

- [a] the book value<sup>1</sup> amount of the capital which the credit institution holds in the investee credit institution and/or financial institution; and
- [b] all instruments which the credit institution holds in the investee credit institution and/or financial institution which are eligible as own funds.

**COD 2. Aggregate holdings in other credit and/or financial institutions of up to 10% of their capital and instruments which the credit institution holds in such institutions which are eligible as own funds (other than those included in COD 1 above) which in aggregate exceed 10% of item 8.0.0**

When a credit institution holds capital and instruments in credit and/or financial institutions other than those included in COD 1 above, the aggregate book value<sup>1</sup> which exceeds 10% of the credit institution’s own funds as per COD 11 shall be deducted as per note (6) of Appendix 1.

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<sup>4</sup> Ordinary and Preference Shares.

**COD 3. Shareholding in a company other than a credit and/or financial institution which is not supervised on a consolidated basis. (The 15% and 60% shall be calculated on the basis of item 7.0.0)**

Report any shareholding in any company other than a credit institution, financial institution or undertaking carrying on activities which are a direct extension of banking or concern services ancillary to banking, such as leasing, factoring, the management of unit trusts, the management of data processing services, or any other similar activity, which is not supervised on a consolidated basis in terms of Article 15(1)(d) particularly to proviso (v) of the said Article, whereby the book value<sup>1</sup> of an investment amount exceeding either the 15% or 60% limits in terms of proviso (i) and (ii) respectively of Article 15(1)(d), are deducted from the institution's Own Funds and when both limits are exceeded, the greater of the excess amounts shall be deducted in the Own Funds computation.

**COD 4. Participations held in insurance undertakings, reinsurance undertakings and insurance holding companies**

For the purposes of this paragraph, a 'participating interest' shall mean:

- (a) rights in the capital of an insurance undertaking, reinsurance undertaking and insurance holding company whether or not represented by certificates, which, by creating a durable link with those undertakings, are intended to contribute to the company's activities; or
- (b) the ownership, direct or indirect, of 20% or more of the voting rights or capital of an insurance undertaking, reinsurance undertaking and insurance holding company.

**COD 5. Other instruments held in respect of insurance undertakings, reinsurance undertakings and insurance holding companies in which a participation is maintained**

A 'participating interest' shall have the same meaning as in COD 4 above. 'Other instruments' shall mean instruments that are eligible for the available solvency margin of insurance companies.

***Note re COD 1 to 5.** For the purposes of COD 1 to 5 above, where shares in another credit institution, financial institution, insurance or reinsurance undertaking or insurance holding company are held temporarily for the purposes of a financial assistance operation designed to reorganise and save that entity in terms of the requirements of Article 15(1)(d)(iv) of the Act, the authority may waive the deductions of COD 1 to 5 above.*

**COD 6. Deduction in line with the First schedule of the Financial Conglomerates Regulation**

As an alternative to the deduction of the items referred to in COD 4 and 5, the authority may allow credit institutions to apply, mutatis mutandis methods 1, 2, or 3 of item II, Technical Calculations Methods, of the First schedule to LN 521 of 2004 – Financial Conglomerates Regulations.

Method 1 (Accounting Consolidation) may be applied only if the authority is confident about the level of integrated management and internal control regarding the entities which would be included in the scope of consolidation.

The method chosen shall be applied in a consistent manner by the credit institution over time.

**COD 7. Securitisation exposures not included in risk-weighted assets**

Deduct the exposure amount of securitisation positions which would otherwise receive a risk weight of 1250% in accordance with Appendix 3 of Banking Rule BR/04.

This item shall not be deducted, if it has already been included in the calculation of risk weighted exposure amounts, in the computation of the Capital Requirements.

**COD 8. The expected loss amount calculated using the Internal Ratings Based approach of the Capital Requirements Rule (excess over specific provisions)**

For credit institutions calculating their credit risk capital requirement utilising an Internal Risk Based Approach, this item is to be calculated in line with Appendix 2, Section II.2, Paragraph 4.1.0 of BR/04.

**COD 9. Total other deductions (sum of COD 1 to COD 8)**

This sum is computed automatically.

**COD 10. Half total other deductions (i.e. half COD 9)**

This amount is computed automatically.

**Memorandum item 1:**

Itemise any entry reported under item 1.1.10 'Other Reserves'

**Memorandum item 2:**

Itemise and describe instruments being reported under item 1.1.13 'Innovative and Non-Innovative Instruments'. To include type of instrument, date of maturity (if any), redemption date (if any) and any other relevant information.

**9.0.0 LIMITS**

9.1.0 The 'Original Own Funds', 'Additional Own Funds' and 'Supplementary Own Funds' of a credit institution which is subject to the Capital Adequacy Rule BR/08 must be assigned between the banking book and the trading book. Capital must first be assigned to the banking book (including counterparty and settlement risks), and sufficient capital must be left to support the trading book. The bank only meets its requirements if it has sufficient capital for both books.

The Risk Weighted Assets of the banking book should be covered by Original Own Funds and Additional Own Funds. Supplementary Own Funds cannot be used to support the banking book or counterparty and settlement risks under the Capital Adequacy Rule BR/08. Any remaining Original Own funds will be eligible for the trading book capital requirements.

- 9.2.0 The following limits shall apply:
- 9.2.1 The amount of the items which may be included in the ‘Lower Tranche’ of the ‘Additional Own Funds’ must not exceed 50% of item 1.3.7 ‘TOTAL Original Own Funds AFTER application of prudential filters BEFORE Other Deductions brought forward from excess in Additional Own Funds’. Vide deduction as per item 2.2.1.
- 9.2.2 Item 2.6.0 ‘TOTAL Eligible Additional Own Funds’ shall not exceed item 1.4.0 ‘TOTAL Original Own Funds AFTER application of prudential filters and AFTER Other Deductions brought forward from excess in Additional Own Funds’.
- 9.2.3 Item 2.6.0 ‘TOTAL Eligible Additional Own Funds’ and item 4.1.0 ‘Subordinated loan capital’ used to meet the trading book capital requirements must not in total exceed 150% of item 1.4.0 ‘TOTAL Original Own Funds AFTER application of prudential filters and AFTER Other Deductions brought forward from excess in Additional Own Funds’ left to meet trading book activities and foreign exchange risk.
- 9.2.4 It is the policy of the authority that, at overall consolidated group level or at solo level if a credit institution is not part of a consolidated group the sum of item 2.6.0 ‘TOTAL Eligible Additional Own Funds’ and item 4.3.0 ‘Total Supplementary Own Funds’ cannot exceed 100% of the credit institution/group item 1.4.0 ‘TOTAL Original Own Funds AFTER application of prudential filters and AFTER Other Deductions brought forward from excess in Additional Own Funds’. This limit cannot be exceeded without the authority’s permission, which will only normally be granted where a credit institution/group trading book accounts for a substantial part of its business.
- 9.2.5 Report all Innovative and Non-Innovative Instruments under item 1.1.13 ‘Innovative and Non-Innovative’ Instruments’. No more than 15% of item 1.3.7 ‘TOTAL Original Own Funds AFTER application of prudential filters BEFORE Other Deductions brought forward from excess in Additional Own Funds’ shall consist of Innovative and Non-Innovative Instruments. The deduction of item 1.2.8 from item 1.1.14 will help achieve the 15% limit. The excess of Innovative and Non-Innovative Instruments over the 15% shall be transferred to Additional Own Funds through item 2.1.3. item 2.1.3 shall be equal to item 1.2.8.
- 9.2.6 COD 9 ‘Total other deductions’ shall be deducted half from item 1.1.14 ‘TOTAL Gross Original Own Funds’ and half from items 2.1.5 ‘Total Upper Tranche Additional Own Funds’ and 2.1.11 ‘Total Lower Tranche Additional Own Funds’ less item 2.2.1 ‘Excess of the limits of the lower tranche of the Additional Own Funds’. To the extent that the deduction from the total of items 2.1.5 and 2.1.11 less item 2.2.1 is greater, the excess shall be deducted from item 1.3.7. COD 7 ‘Securitisation exposures not included in risk-weighted assets’ shall not be deducted if it has been included in the calculation of risk-weighted exposure amounts for the purposes of Appendix 1 of BR/04 and as specified in Appendix 3, Section I.4 of the same rule.

9.2.7 The authority may authorise credit institutions to exceed the limits laid down in paragraphs 9.2.1 to 9.2.3 of this Rule, in temporary and exceptional circumstances.

#### **10.0.0 CONSOLIDATED OWN FUNDS**

10.1.0 When a credit institution is reporting consolidated Own Funds, the consolidated balance sheet figures shall be used. The balance sheet figures of the credit institution shall be used when reporting unconsolidated Own Funds<sup>6</sup>.

10.2.0 When Own Funds are being calculated by the credit institution for unconsolidated purposes, items 1.1.11, 2.1.4 and 2.1.10 'Minority interests', shall not apply.

10.3.0 When consolidated Own Funds are being reported, COD 1 and 2 of 'Total other deductions' shall not include holdings in subsidiary credit and/or financial institutions which are included in the consolidated balance sheet. Holding of share capital (and other items) in other credit and/or financial institutions which are specified in COD 3 of 'Total other deductions' shall, however, be deducted from the total of Gross Own Funds. COD 4 shall not include participations held in insurance undertakings, reinsurance undertakings and insurance holding companies, while COD 5 shall not include other instruments held in respect of insurance undertakings, reinsurance undertakings and insurance holding companies in which a participation is maintained if included in the consolidation.

10.4.0 When minority interest(s), translation differences and any other differences arising on consolidation are debit balances, they must be shown as negative amounts under the relevant Own Funds items.

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<sup>6</sup> Refer to paragraph 14 of the Rule.