Guernsey Financial Services Commission

BASEL III:

CAPITAL ADEQUACY AND LEVERAGE RATIO

A CONSULTATION PAPER ISSUED BY THE GUERNSEY FINANCIAL SERVICES COMMISSION

July 2015

The Guernsey Financial Services Commission invites comments on this consultation paper. Lynn Harris in the Commission's Banking Division is co-ordinating responses from industry and your comments should be submitted by no later than 9 October 2015.

Responses should be sent to:

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Additionally, the Commission would encourage subsidiary banks who wish to discuss specific scenarios to meet with it during the consultation period.

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Glossary of Terms

AT1	Additional Tier 1 Capital
Basel III capital adequacy standard	"A global regulatory framework for more resilient banks and banking systems", issued in December 2010 by the Basel Committee and revised in June 2011
CDs	Crown Dependencies
CET1	Common Equity Tier 1 Capital
ICAAP	Internal Capital Adequacy Assessment Process
ICG	Individual Capital Guidance
Leverage Ratio Paper	"Basel III leverage ratio framework and disclosure requirements" issued in January 2014 by the Basel Committee
RWAs	Risk Weighted Assets
T2	Tier 2 Capital

1: Executive Summary

1.1 Overview

1. This paper contains full details of the proposals to amend the minimum regulatory capital adequacy requirements that apply to licensed deposit takers that are incorporated in Guernsey.

1.2 What is proposed?

2. The substantive changes being proposed in updated guidance are as follows:

   - Revised definitions of regulatory capital;
   - Establishment of new minimum regulatory capital requirements;
   - Certain changes to the calculation of Risk Weighted Assets;
   - The introduction of a Leverage Ratio Reporting Requirement.

   All of the above changes are consistent with the Basel III capital adequacy standard.

3. The Commission also intends to revise the prudential reporting forms to reflect the above changes.

1.3 Rationale for change

4. The changes proposed in this consultation paper represent a proportionate implementation of international regulatory standards consistent with the Commission’s aims to ensure effective supervision of the banking sector and maintain the reputation of the Bailiwick.

1.4 Who would be affected?

5. Licensed deposit takers that are incorporated in Guernsey, herein referred to as “banks”, are affected by the proposals.

2: Consultation

2.1 Basis for the consultation

6. The Commission has issued this consultation paper in accordance with s36A(1) of the Banking Supervision (Bailiwick of Guernsey) Law 1994 as amended, under which the Commission, "after consultation with such other persons as appear to the Commission to be appropriate including, without limitation, persons representative of that part of the Bailiwick's financial services industry which carries on business regulated by this Law, may issue such codes of practice as the Commission thinks necessary."

2.2 Responding to the consultation

7. The Commission invites comments from interested parties on the proposals included in this consultation paper. Paragraphs in relation to the proposed changes are numbered so wherever possible respondents should quote the paragraph reference to which their comments pertain.

8. Where comments are made by an industry body or association, that body or association should also provide a summary of the type of individuals and/or institutions that it represents.

9. Respondents are asked to respond as specifically as possible and, where costs are referred to, to quantify those costs.

10. The Commission would encourage those Guernsey incorporated banks who want to discuss specific scenarios to get in touch during the consultation period.

2.3 Next steps

11. Please respond to this consultation paper by no later than 5.00pm on 9 October 2015. The Commission will take all responses into account before publishing the finalised details of the revised capital regime. The Commission will consider consultation responses in setting the implementation date for the revised regime with the aim of implementing in the first half of 2016.

3: The Commission

12. The Guernsey Financial Services Commission is the regulatory body for the finance sector in the Bailiwick of Guernsey. The Commission's primary objective is to regulate and supervise financial services in Guernsey, with integrity and efficiency, and in so doing help to uphold the international reputation of Guernsey as a finance centre.

13. The Commission's general functions are prescribed in The Financial Services Commission (Bailiwick of Guernsey) Law, 1987 as follows:

- To take such steps as the Commission considers appropriate or expedient for the effective supervision of finance business in the Bailiwick.
- To provide the States of Guernsey, the States of Alderney or the Chief Pleas of Sark with reports, advice and assistance with any matter connected with finance business.
- To prepare and submit to the States of Guernsey, the States of Alderney or the Chief Pleas of Sark with reports, recommendations and schemes for the statutory regulation of finance business and generally for the revision of legislation appertaining to companies and other forms of business undertakings.
- The countering of financial crime and the financing of terrorism.
- To take such steps as the Commission considers necessary or expedient for
    - maintaining confidence in the Bailiwick's financial services sector, and
    - the safety, soundness and integrity of that part of the Bailiwick's financial services sector for which it has supervisory responsibility.
- All such other functions as the States of Guernsey may assign.

4: Background

4.1 Current legislation and policy

14. Schedule 3 to The Banking Supervision (Bailiwick of Guernsey) Law, 1994 sets out the minimum criteria for bank licensing under the Law. One of these criteria requires banks to conduct business in a prudent manner and a key component of this criterion is the requirement to maintain a capital base of an amount which the Commission considers appropriate. A bank is required to have sufficient capital commensurate with the nature and scale of the bank's operations and sufficient to safeguard the interests of depositors having regard to the nature and scale of operations, risks inherent in those operations and any other factors appearing to the Commission to be relevant. The Commission sets out in policy the detailed framework setting out the regulatory capital requirements applicable to licensed institutions.

15. The proposals in this paper will require revision of the policy framework but no change to the Law.

4.2 International considerations driving the proposals

Basel III

16. In June 2006, the Basel Committee on Banking Supervision ("Basel Committee") issued, in comprehensive form, a framework for supervisory regulations governing the capital adequacy of international banks. This document, "International Convergence of Capital Measurement and Capital Standards", has become known as "Basel II".

17. Latterly, the Basel Committee has worked to revise Basel II to strengthen the framework and address the lessons of the financial crisis. This work has resulted in a number of documents being issued that either revise Basel II or establish new international standards regarding the financial wellbeing of international banks. Collectively, this initiative is described by the Basel Committee as "Basel III" and it encompasses both capital adequacy and liquidity measures.

18. This consultation paper focuses, primarily, on the following documents issued by the Basel Committee as part of the Basel III initiative:

    "A global regulatory framework for more resilient banks and banking systems", issued December 2010 and revised June 2011, referred to herein as the "Basel III capital adequacy standard"; and

    "Basel III leverage ratio framework and disclosure requirements" issued in January 2014 by the Basel Committee referred to herein as the "Leverage Ratio Paper".

4.3 Tri-party Group

19. Following the issuance of Basel II, the Guernsey Financial Services Commission ("GFSC"), the Isle of Man Financial Supervision Commission ("IOMFSC") and the Jersey Financial Services Commission ("JFSC"), jointly the "Tri-party Group", worked together to establish a unified approach, reflecting our similar responsibilities as host supervisors, wherever possible, to implementing Basel II during the period 2005 to 2008. As a result of this work the current regulatory framework in Guernsey is consistent with Basel II.

20. The Tri-Party Group distributed a Discussion Paper on Basel III in September 2012 (the "Initial DP") to all banks that are incorporated in the Crown Dependencies ("CDs") – Guernsey, Isle of Man and Jersey - to provide information on Basel III and an indication of the Group's initial views and in order to solicit feedback.

21. The Tri-Party Group distributed three further discussion papers containing detailed proposals and building on those in the Initial DP. The Discussion Paper on Basel III: Capital Adequacy (the "Capital Paper") was issued in December 2013 followed in January 2014 by a further Discussion Paper on "Domestic Systemically Important Banks (including Recovery and Resolution)" and in June 2014 a Discussion Paper on Basel III Leverage Ratio was issued.

22. The Tri-Party Group has reviewed the comments received from banks in relation to the discussion papers and has issued feedback papers in relation to these.

23. This consultation paper is issued by the Commission and makes proposals reflecting the aforementioned policy development work of the Tri-party Group covered in the Capital Paper and the Discussion Paper on Basel III Leverage Ratio only. It is proposed that implementation of other elements of Basel III will be implemented at a later point. Each jurisdiction will conduct its Basel III implementation consultation process separately on its own timetable, in order to ensure local matters are fully addressed, but it is the intention to maintain alignment of the proposals across the jurisdictions wherever possible.

5: The Proposals

24. The Commission proposals are discussed in detail under the following headings:

1. Definition of capital
2. Amendment to the Risk Weighted Assets calculation
3. Minimum capital requirement
4. Leverage Ratio

5.1 Definition of Capital

25. This paper proposes the introduction of a revised definition of regulatory capital consistent with the Basel III capital adequacy standard. The Basel III capital adequacy standard creates a new, higher quality, sub-category of capital – Common Equity Tier 1 ("CET1"). Certain instruments ineligible for CET1 may be included within Tier 1 and Tier 2 capital but the definition is now stricter than before and the rules relating to deductions have been clarified to ensure that most deductions are now applied fully against CET1 capital. Non-CET1 eligible Tier 1 instruments are referred to as Additional Tier 1 capital ("AT1"). Tier 1 refers to the total of CET1 and AT1.

26. The Commission's detailed proposals for implementation of a revised definition of regulatory capital are provided in Appendices 1 and 2 to this document, which respectively set out the proposed revised regulatory capital reporting of the Commission's form BSL/2 and revised Guidance to completing the Balance Sheet module (Module 6) of BSL/2 (the "Guidance").

27. It should be noted that the proposed revised framework allows for certain transitional adjustments to be applied reducing the severity of any immediate impact of the revised policy. These transitional adjustments are consistent with the Basel III capital adequacy standard and are set out in the revised Guidance.

Question 1: Do you have any comments on the proposed revisions to the definition of regulatory capital?

5.2 Amendment to Risk Weighted Assets Calculation

28. The proposed revisions to Risk Weighted Assets in this paper do not cover most of the Basel III changes to risk weightings. Many of the Basel III changes would only have a significant impact on banks with trading books or those involved in securitisation, the local impact of which is expected to be extremely limited. The changes proposed in this paper relate to the risk weighting of items previously deducted from capital under the current regime.

29. In the calculation of regulatory capital the amount by which three items – (1) significant investments in the common equity of banking, financial and insurance entities, (2) mortgage servicing rights and (3) Deferred Tax Assets arising from temporary differences – are above individual or joint thresholds is deducted from capital. Any residual exposures below the thresholds will be required to be risk weighted at 250%.

30. In addition the following items previously treated as deductions are treated as exposures with a 1,250% risk weight:

    - Certain securitisation exposures; and
    - Significant investments in commercial entities.

    The new 250% and 1,250% risk weighted items will be reported in section K of Module 1 of the BSL/2. Extracts of the revised reporting form and guidance are provided at Appendix 3.

    Question 2: Do you have any comments on the use of the 250% and 1,250% risk weights for some items currently deducted from capital?

5.3 Minimum Capital Requirement

Pillar 1 Capital Requirement

31. Banks are required to maintain a minimum total capital ratio of 10.5%, comprising an 8% requirement plus a 2.5% Capital Conservation Buffer.

32. Banks are required to maintain a minimum CET1 capital ratio of 8.5%, comprising a 6% requirement plus a 2.5% Capital Conservation Buffer.

33. The Capital Conservation Buffer of 2.5% is comprised of Common Equity Tier 1.

34. Capital distribution constraints will be imposed on a bank when capital levels fall within the Capital Conservation Buffer range, at the discretion of the Commission. The Commission expects all banks to operate above 10.5% - and the approach to the Pillar 2 charge is set out below. All dividend payments will continue to require the agreement of the Commission.

35. The Commission expects that banks will not choose in normal times to operate in the buffer range. However, in the unlikely event that a bank breaches the Capital Conservation Buffer, the bank will be required to put in place a capital recovery plan agreed with the Commission so as to restore the Buffer.

36. As previously indicated in the Capital Paper, there is no proposal to implement a Counter-cyclical Buffer as proposed under Basel III.

37. It should be noted that the decision has been made by the Commission to consult on an 8% total regulatory capital requirement with a 2.5% Capital Conservation Buffer as opposed to the 10% requirement originally proposed in the Capital paper. It was considered that the original proposal in Guernsey would fall short of the aggregate 10.5% requirement under Basel III because Guernsey has no current practice of operating a Pillar 1 buffer above minimum requirement. The decision was made therefore to propose a buffer and to do so consistently with Basel III. The Commission's view is that the total Pillar 1 requirement in the CDs will remain broadly consistent.

38. It should also be noted that, in due course, a consultation paper on Domestic Systemically Important Banks ("D-SIBs") will be published building on the previously issued Tri-Party Group discussion paper. Proposals may include the setting of Higher Loss Absorbency capital requirements where a bank is identified as a D-SIB.

Question 3: Do you have any comments regarding the proposed Pillar 1 capital requirements?

Pillar 2

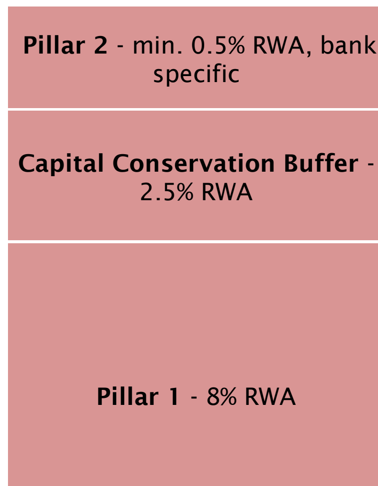
39. The Commission will continue to apply Pillar 2 additional capital add-ons on a case-by-case basis as part of the Supervisory Review and Evaluation Process. All banks will be subject to a Pillar 2 capital add-on reflecting the Commission's assessment of the degree to which a bank has failed to adequately and prudently address relevant Pillar 2 risks. The aggregate Pillar 2 add-on is subject to a floor of 0.5% and banks will be expected to propose Pillar 2 add-ons above 0.5%

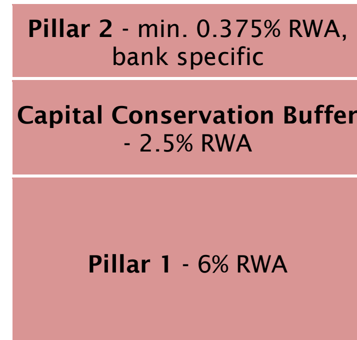
40. The Commission is changing the form of the Pillar 2 capital requirement changing from the Individual Capital Guidance ("ICG") approach (where the aggregate Pillar 1 and 2 requirement is expressed as a percentage of the Pillar 1 requirement) to an approach where the variable element is expressed as a percentage of risk-weighted assets ("RWAs"). The Commission may, in addition, prescribe Pillar 2 add-ons in terms of fixed capital amounts where this is more appropriate (see Appendix 8 for illustrative example).

41. Pillar 2 capital should comprise at least 75% CET1.

42. For the avoidance of doubt, the Commission will take action in the event that a bank's capital falls below that of its agreed regulatory capital – that is the sum of both its Pillar 1 and Pillar 2 capital. However, the Commission does not require that a bank holds an additional buffer over and above that level; though of course the bank may choose to do this.

43. The table below illustrates the new regulatory capital requirements.





Question 4: Are there any questions or comments regarding the proposed approach to Pillar 2?

Transitional

44. Upon implementation of the revised regulatory capital approach the Commission will perform a preliminary review of currently prescribed ICGs and provide revised guidance in the new format. This guidance will also be adjusted to reflect any double-counting arising from the effective increase in Pillar 1 capital requirements with the introduction of the Capital Conservation Buffer. Specifically the Commission will consider where current Pillar 2 add-ons relate to inadequacy of Pillar 1 capital requirements e.g. in the case of credit risk, operational risk market risk in the banking book and settlement risk. Pillar 2 add-ons may be revised downwards where the new higher Pillar 1 requirement (including the Capital Conservation Buffer) may now adequately address a particular risk. Any adjustment to Pillar 2 requirements resulting from this review process will be subject to a floor on the total regulatory capital requirement set at the level in place prior to implementation of the new capital approach. Appendix 7 provides illustrative examples of Pillar 2 add-on revision.

45. As is currently required, banks' Internal Capital Adequacy Assessment Processes ("ICAAPs") should include consideration of whether the capital requirement generated by the Pillar 1 calculation gives a realistic picture of risk exposure, with respect to risks within the scope of Pillar 1 i.e. credit risk and operational. The effective increase in Pillar 1 requirements may require banks to revise this assessment in future ICAAP iterations.

46. Where a bank is concerned that any revision to its Pillar 2 guidance, following the implementation of this policy, results in a total regulatory capital requirement which is no longer consistent with the bank's risk profile then the bank should raise such concerns with the Commission. Otherwise, banks will be able to review their revised Pillar 2 charge in line with the same periodicity as currently set within each bank's PRISM timeline.

Question 5: Are there any questions or comments regarding the proposed transitional arrangements?

5.4 Leverage Ratio

47. Banks are required to report a leverage ratio on a quarterly basis as part of the BSL/2 reporting form.

48. No minimum leverage ratio requirement is proposed at this time but the Commission may take banks' leverage levels into consideration in their review of banks' capital adequacy under Pillar 2. As a rule of thumb, a leverage ratio below 3% will merit discussion.

Leverage ratio definition

49. The leverage ratio is defined as the Capital Measure (the numerator) divided by the Exposure Measure (the denominator), with this ratio expressed as a percentage.

50. The Capital Measure for the leverage ratio is Tier 1 capital as defined in Module 6 of the BSL/2 (see section 5.1 above).

51. The Exposure Measure for the leverage ratio should generally follow the accounting measure of assets subject to the following principles:

- on-balance sheet, non-derivative exposures are included in the Exposure Measure net of specific provisions and valuation adjustments (e.g. credit valuation adjustments);
- netting of loans and deposits is not allowed.

52. Physical or financial collateral, guarantees or credit risk mitigation purchased are not allowed to reduce on-balance sheet exposures.

53. A bank's total Exposure Measure is the sum of the following exposures: (a) on-balance sheet exposures, (b) derivative exposures, (c) securities financing transaction exposures, and (d) other off-balance sheet exposures. The specific treatment for these four main exposure categories is defined in the reporting forms and guidance to completing Module 11 of BSL/2 which is set out in Appendices 5 and 6 respectively.

Question 6: Are there any questions or comments regarding the proposed leverage ratio reporting requirement?

Question 7: Is there anything in the proposals that is unclear? If so, please provide examples.

APPENDIX 1

BSL/2 Module 6

MODULE 6				
	Capital	£000's	£000's	£000's
Item	**Description**	**Value**	**Transitional**	**Transitional cap**
A	**Common Equity Tier 1 capital: instruments and reserves**			
A.1	Directly issued qualifying common share capital (and equivalent for non-joint stock companies) plus related stock surplus			
A.2	Retained earnings			
A.3	Accumulated other comprehensive income (and other reserves)			
A.4	Directly issued capital subject to phase out from CET1 (only applicable to non-joint stock companies)			
A.4a	Public sector capital injections grandfathered until 1 January 2018			
A.5	Common share capital issued by subsidiaries and held by third parties (amount allowed in group CET1)			
A.6	**Common Equity Tier 1 capital before regulatory adjustments**	-	-	
	Common Equity Tier 1 capital: regulatory adjustments			
A.7	Prudential valuation adjustments			
A.8	Goodwill (net of related tax liability)			
A.9	Other intangibles, other than mortgage-servicing rights (net of related tax liability)			
A.10	Deferred tax assets that rely on future profitability excluding those arising from temporary differences (net of related tax liability)			
A.11	Cash-flow hedge reserve			
A.12	Shortfall of provisions to expected losses			
A.13	Securitisation gain on sale (as set out in paragraph 562 of Basel II framework)			
A.14	Gains and losses due to changes in own credit risk on fair valued liabilities			
A.14a	*of which: amount relating to DVAs recognised on origination*			
A.15	Defined-benefit pension fund net assets			
A.16	Investments in own shares (if not already netted off paid-in capital on reported balance sheet)			
A.17	Reciprocal cross-holdings in common equity			
A.18	Investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation, net of eligible short positions, where the bank does not own more than 10% of the issued share capital (amount above 10% threshold)			
A.19	Significant investments in the common stock of banking, financial and insurance entities that are outside the scope of regulatory consolidation, net of eligible short positions (amount above 10% threshold)			
A.20	Mortgage servicing rights (amount above 10% threshold)			
A.21	Deferred tax assets arising from temporary differences (amount above 10% threshold, net of related tax liability)			
A.22	Amount exceeding the 15% threshold			
A.23	*of which: significant investments in the common stock of financials*			
A.24	*of which: mortgage servicing rights*			
A.25	*of which: deferred tax assets arising from temporary differences*			
A.26	National specific regulatory adjustments, including Pillar 2 deductions applied to CET1 capital			
A.26a	Regulatory adjustments applied to CET1 capital in respect of amounts subject to pre-Basel III treatment: pension liabilities			
A.26b	Regulatory adjustments applied to CET1 capital in respect of amounts subject to pre-Basel III treatment: available-for-sale reserves			
A.27	Regulatory adjustments applied to Common Equity Tier 1 due to insufficient Additional Tier 1 and Tier 2 to cover deductions			
A.28	**Total regulatory adjustments to Common equity Tier 1**	-	-	
A.29	**Common Equity Tier 1 capital (CET1)**	-	-	

B	**Additional Tier 1 capital: instruments**			
B.1	Directly issued qualifying Additional Tier 1 instruments plus related stock surplus			
B.2	*of which: classified as equity under applicable accounting standards*			
B.3	*of which: classified as liabilities under applicable accounting standards*			
B.4	Directly issued capital instruments subject to phase out from Additional Tier 1			
B.5	Additional Tier 1 instruments (and CET1 instruments not included in A.5) issued by subsidiaries and held by third parties (amount allowed in AT1)			
B.6	*of which: instruments issued by subsidiaries subject to phase out*			
B.7	**Additional Tier 1 capital before regulatory adjustments**	**-**	**0**	
	Additional Tier 1 capital: regulatory adjustments			
B.8	Investments in own Additional Tier 1 instruments			
B.9	Reciprocal cross-holdings in Additional Tier 1 instruments			
B.10	Investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation, net of eligible short positions, where the bank does not own more than 10% of the issued common share capital of the entity (amount above 10% threshold)			
B.11	Significant investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation (net of eligible short positions)			
B.12	National specific regulatory adjustments, including Pillar 2 deductions applied to Additional Tier 1 capital			
B.13	Regulatory adjustments applied to Additional Tier 1 due to insufficient Tier 2 to cover deductions			
B.14	**Total regulatory adjustments to Additional Tier 1 capital**	**0**	**0**	
B.15	**Additional Tier 1 capital (AT1)**	**-**	**0**	
B.16	**Tier 1 capital (T1 = CET1 + AT1)**	**-**	**-**	
C	**Tier 2 capital: instruments and provisions**			
C.1	Directly issued qualifying Tier 2 instruments plus related stock surplus			
C.2	Directly issued capital instruments subject to phase out from Tier 2			
C.3	Tier 2 instruments (and CET1 and AT1 instruments not included in items A.5 and B.5) issued by subsidiaries and held by third parties (amount allowed in group Tier 2)			
C.4	*of which: instruments issued by subsidiaries subject to phase out*			
C.5	Provisions			
C.6	**Tier 2 capital before regulatory adjustments**	**0**	**0**	
	Tier 2 capital: regulatory adjustments			
C.7	Investments in own Tier 2 instruments			
C.8	Reciprocal cross-holdings in Tier 2 instruments			
C.9	Investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation, net of eligible short positions, where the bank does not own more than 10% of the issued common share capital of the entity (amount above the 10% threshold)			
C.10	Significant investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation (net of eligible short positions)			
C.11	National specific regulatory adjustments, including Pillar 2 deductions applied to Tier 2 capital			
C.12	**Total regulatory adjustments to Tier 2 capital**	**0**		
C.13	**Tier 2 capital (T2)**	**0**	**0**	
C.14	**Total capital (TC = T1 + T2)**	**0**	**0**	

MODULE 6

			Value
D	**Capital Memorandum Items**		
		Amounts below the thresholds for deduction (before risk weighting)	
	D.1	Non-significant investments in the capital of other financials	
	D.2	Significant investments in the common stock of financials	
	D.3	Mortgage servicing rights (net of related tax liability)	
	D.4	Deferred tax assets arising from temporary differences (net of related tax liability)	
		Applicable caps on the inclusion of provisions in Tier 2	
	D.5	Provisions eligible for inclusion in Tier 2 in respect of exposures subject to standardised approach (prior to application of cap)	
	D.6	Cap on inclusion of provisions in Tier 2 under standardised approach	
	D.7	Provisions eligible for inclusion in Tier 2 in respect of exposures subject to internal ratings-based approach (prior to application of cap)	
		Capital instruments subject to phase-out arrangements	
80	D.8	Current cap on CET1 instruments subject to phase out arrangements	
81	D.9	Amount excluded from CET1 due to cap (excess over cap after redemptions and maturities)	
82	D.10	Current cap on AT1 instruments subject to phase out arrangements	
83	D.11	Amount excluded from AT1 due to cap (excess over cap after redemptions and maturities)	
84	D.12	Current cap on T2 instruments subject to phase out arrangements	
85	D.13	Amount excluded from T2 due to cap (excess over cap after redemptions and maturities)	

APPENDIX 2 – Module 6 Guidance

MODULE 6

Guidance to completing the Balance Sheet module of BSL/2

Glossary

The following abbreviations are used within the document:

AT1	-	**A**dditional **T**ier **1**
Basel III capital adequacy standard	-	"A global regulatory framework for more resilient banks and banking systems", issued in December 2010 by the Basel Committee and revised in June 2011
CD	-	**C**ertificate of **D**eposit
CET1	-	**C**ommon **E**quity **T**ier **1**
CP	-	**C**ommercial **P**aper
DTA	-	**D**eferred **T**ax **A**sset
DTL	-	**D**eferred **T**ax **L**iability
DVA	-	**D**ebit **V**aluation **A**djustment
FRN	-	**F**loating **R**ate **N**ote
PSE	-	**P**ublic **S**ector **E**ntity
T2	-	**T**ier **2**

Overview

Introduction

Module 6 is designed to provide the Commission with an assessment of a bank's balance sheet and off-balance sheet activities including, for subsidiaries only, its capital resources.

Branches are only required to complete the Assets and Liabilities sheets of Module 6.

Throughout Module 6, areas where data should be input are indicated visually in the sheets by the use of white boxes – no data should be entered elsewhere and every box should be completed, entering zero where appropriate.

For branches only, an Off Balance sheet worksheet has been included. This is a TOTALS only version of the Off Balance sheet worksheet used by subsidiaries from Module 1.

The "Checks" worksheet has been moved next to the "Front Sheet".

Capital

Types of capital

For supervisory purposes, capital is split into three categories: Common Equity Tier 1 ("CET1), Additional Tier 1("AT1") and Tier 2 ("T2"). These categories reflect the varying quality of capital that different instruments provide.

Annexes A to C along with detailed guidance set out below provide further definition of the three types of capital.

Transitional arrangements

Certain items in the regulatory capital calculation will be eligible for transitional adjustments.

Regulatory adjustments to CET1, AT1 and Tier 2 capital will apply at 60% in 2016, 80% on 1 January 2017, and reach 100% on 1 January 2018.

Specific adjustments applicable are described in the detailed item guidance in the table below and it is indicated where transitional arrangements apply.

With respect to the reporting of transitional adjustments, three columns are used in the Module 6 capital section with two columns (in some cases, split into two rows) used to provide information on transitional items.

Banks are required to report:

- The full amount allowed (including due to transitional adjustments) in the column headed "Value";
- The full amount of the item (without any adjustment) to which transitional adjustments apply in the column headed "Transitional"; and
- The relevant percentage in the column headed "Transitional cap".

- A series of illustrative examples of the application and reporting of transitional arrangements is provided in Annex D.

Detailed guidance

Item	Description	Guidance
A	**Common Equity Tier 1 Capital**	
A.1	Directly issued qualifying common share capital (and equivalent for non-joint stock companies) plus related stock surplus	Common share capital plus related share premium. Instruments in this classification must meet all of the criteria in Annex A.
A.2	Retained earnings	Retained earnings from prior years, net of current year losses but only including auditor certified profits.
A.3	Accumulated other comprehensive income (and other reserves)	Other reserves, net of any reduction in the current year but only including increases that are auditor certified.
A.4	Directly issued capital subject to phase out from CET1 (only applicable to non-joint stock companies)	Leave blank
A.4.a	Public sector capital injections grandfathered until 1 January 2018	Leave blank

Item	Description	Guidance
A.5	Common share capital issued by subsidiaries and held by third parties (amount allowed in group CET1)	To be used by banks that own subsidiaries and have issued common share capital that is held by third parties, and only then in the case of prudential reporting submitted on a consolidated basis. The amount allowed would be limited to the amount required to meet regulatory requirements in respect of CET1 capital, with transitional adjustments applying to any excess. The transitional caps applying for this item are: (1) 40% in 2016 and (2) 20% in 2017. No excess is recognised in 2018 and later years. For further guidance, reference should be made to paragraphs 62 and 94(e) of the Basel III capital adequacy standard for full details.
A.6	**Common Equity Tier 1 capital before regulatory adjustments**	**Automatically completed, being the sum of A.1 to A.5**
A.7	Prudential valuation adjustments	Adjustments should be made here for assets held at fair value but which are illiquid. Where applicable, banks should consider the guidance contained in section VIII, “Treatment for illiquid positions”, of the Basel Committee paper titled “Revisions to the Basel II market risk framework”, issued July 2009. It should be noted that this guidance applies adjustments to positions in the banking book. Transitional arrangements apply.
A.8	Goodwill (net of related tax liability)	All goodwill should be shown here (net of any associated deferred tax liability which would be extinguished if the asset becomes impaired or derecognised under the relevant accounting standards) and deducted from Common Equity Tier 1 Capital.
A.9	Other intangibles, other than mortgage-servicing rights (net of related tax liability)	All other intangibles (with the exception of mortgage servicing rights) should be shown here (net of any associated deferred tax liability which would be extinguished if the asset becomes impaired or derecognised under the relevant accounting standards) and deducted from Common Equity Tier 1 Capital.

Item	Description	Guidance
A.10	Deferred tax assets that rely on future profitability excluding those arising from temporary differences (net of related tax liability)	Report all deferred tax assets ("DTAs") that rely on future profitability of the bank be deducted when calculating CET1 capital. For this purpose, deferred tax assets may be netted with associated deferred tax liabilities ("DTLs)" but only if the DTAs and DTLs relate to taxes levied by the same taxation authority and offsetting is permitted by that taxation authority. Where DTAs relate to temporary differences, the proposed amount to be deducted is set out in Item A.21 below. For further guidance reference should be made to paragraph 69, "Deferred tax assets", of the Basel III capital adequacy standard. Transitional arrangements apply.
A.11	Cash-flow hedge reserve	Adjustments to the amount of the cash flow hedge reserve that relates to the hedging of items that are not fair valued on the balance sheet (including projected cash flows) should be derecognised in the calculation of CET1 capital. This means that positive amounts should be deducted and negative amounts should be added back. For further guidance reference should be made to paragraphs 71-72, "Cashflow hedge reserve", of the Basel III capital adequacy standard.
A.12	Shortfall of provisions to expected losses	This concerns banks using advanced approaches. Where applicable, for further guidance reference should be made to paragraph 73, "*Shortfall of the stock of provisions to expected losses*", of the Basel III capital adequacy standard.
A.13	Securitisation gain on sale (as set out in paragraph 562 of Basel II framework)	This concerns banks that issue securitised debt instruments and relates to any increase in equity capital resulting from a securitisation transaction, such as that associated with expected future margin income. Where applicable, for further guidance reference should be made to paragraph 74, "*Gain on sale related to securitisation transactions*", of the Basel III capital adequacy standard.

Item	Description	Guidance
A.14	Gains and losses due to changes in own credit risk on fair valued liabilities	This item should be used to back out any gains or losses resulting from revaluation of own fair valued liabilities that arise due to own-credit related factors. This means that gains would be deducted and losses would be added back. For further guidance, reference should be made to paragraph 75 of the Basel III capital adequacy standard. Transitional adjustments are generally not permitted, with the exception of adjustments as per below. Valuation adjustments on derivative related liabilities relating to own credit factors must be reversed here. The part of a derivative valuation that relates to own-credit risk is referred to as a "debit valuation adjustment, or "DVA". Transitional adjustments for this item are not permitted with the exception of the amount relating to DVAs that arose on origination (to be included here and in addition reported separately in item A.14a).
A.14a	of which: amount relating to DVAs recognised on origination	The amount relating to DVAs that arose on origination should be reported here.
A.15	Defined-benefit pension fund net assets	For each defined benefit pension fund that is an asset on the balance sheet, the asset should be deducted in the calculation of Common Equity Tier 1. For the treatment of liabilities, see Item A.26a
A.16	Investments in own shares (if not already netted off paid-in capital on reported balance sheet).	All of a bank's investments in its own common shares (treasury shares), whether held directly or indirectly, should be deducted here (unless already derecognised under the relevant accounting standards). In addition, any own stock which the bank could be contractually obliged to purchase should be deducted here.
A.17	Reciprocal cross-holdings in common equity	Reciprocal cross holdings in common equity issued by banking, financial and insurance entities should be deducted.

Item	Description	Guidance
A.18	Investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation, net of eligible short positions, where the bank does not own more than 10% of the issued share capital (amount above 10% threshold)	Less significant holdings of common equity issued by banking, financial and insurance entities (those below 10% of the issuing entity's issued share capital) do not require deduction (but see Items A.19 and A.23); but if the total of all such amounts exceeds 10% of total CET1 then the excess must be deducted here. For further guidance, reference should be made to paragraphs 80 to 83 of the Basel III capital adequacy standard. The approach used where the bank also holds Tier 1 or AT1 instruments issued by such entities is to deduct the amount above 10%, divided in the same proportions as the relevant holdings (see items B.10 and C.9).
A.19	Significant investments in the common stock of banking, financial and insurance entities that are outside the scope of regulatory consolidation, net of eligible short positions (amount above 10% threshold)	Where the bank owns investments in the capital of banking, financial and insurance entities, that are outside the scope of regulatory consolidation, and either:- • The bank owns more than 10% of the issued common share capital of the issuing entity; or • where the entity is an affiliate of the bank (which includes all subsidiaries of the CD bank); then investments must be fully deducted following a corresponding deduction approach. This means the deduction should be applied to the same tier of capital for which the capital would qualify if it was issued by the bank itself. If the bank is required to make a deduction from a particular tier of capital and it does not have enough of that tier of capital to satisfy that deduction, the shortfall will be deducted from the next higher tier of capital (e.g. if a bank does not have enough Additional Tier 1 capital to satisfy the deduction, the shortfall will be deducted from Common Equity Tier 1). Investments included above that are common shares will be subject to a threshold treatment whereby investments up to the value of 10% (in total) of the reporting bank's CET1 capital after deductions (items A.7 to A.18 and deductions of Additional Tier 1 and Tier 2 investments applied to CET1 as per the paragraph above) may be excluded from the deduction. For further guidance, reference should be made to paragraphs 84 to 86 of the Basel III capital adequacy standard.

Item	Description	Guidance
A.20	Mortgage servicing rights (amount above 10% threshold)	Intangible assets that arise in connection with providing mortgage servicing, typically in connection with the mortgage assets transferred to a securitisation vehicle. Only the amount in excess of 10% of CET1 may be deducted. For further guidance reference should be made to paragraph 87 of the Basel III capital adequacy standard.
A.21	Deferred tax assets arising from temporary differences (amount above 10% threshold, net of related tax liability)	Deferred tax assets that do not rely on future profitability (see Item A.10). Only the amount in excess of 10% of CET1 may be deducted. Transitional adjustments will apply. For further guidance, reference should be made to paragraph 87 of the Basel III capital adequacy standard.
A.22	Amount exceeding the 15% threshold	The amount by which the aggregate of the three items above (A.19, A.20 and A.21) exceeds 15% of CET 1 (calculated prior to the deduction of these items but after application of all other regulatory adjustments applied in the calculation of CET 1) should be deducted. Transitional adjustments apply only to the amount of the deduction that relates to DTAs. For example, if DTAs totalled 9% and the other two items totalled 12% then the deduction required would be 6% (21% minus 15%), all of which could be said to relate to DTAs and hence all would be subject to transitional adjustments. For further guidance, reference should be made to paragraph 88 of the Basel III capital adequacy standard.
	Note that the amount of the items above (A.19, A.20 and A.21) that are not deducted in the calculation of Common Equity Tier 1 will be risk weighted at 250%.	
A.23	of which: significant investments in the common stock of financials	Items A.23, A.24 and A.25 should be used to provide a break down of the amount reported in A.22 into three sub-components.
A.24	of which: mortgage servicing rights	

Item	Description	Guidance
A.25	of which: deferred tax assets arising from temporary differences	
A.26	National specific regulatory adjustments, including Pillar 2 deductions applied to CET1 capital	This item is to be used where additional deductions are required by the Commission. In the event of deductions being required in connection with Pillar 2, they would typically be required to be made here.
A.26a	Regulatory adjustments applied to CET1 capital in respect of amounts subject to pre-Basel III treatment: pension liabilities	Defined benefit pension fund liabilities, as included on the balance sheet, must be fully recognised in the calculation of Common Equity Tier 1 (i.e. Common Equity Tier 1 cannot be increased through derecognising these liabilities). For each defined benefit pension fund that is an asset on the balance sheet, the asset should be deducted in the calculation of Common Equity Tier 1. In cases where prior to the introduction of this revised framework banks were permitted to add-back pension liabilities in the calculation of regulatory capital then transitional adjustments may be applied. Under transitional arrangements banks may add back a percentage of any pension liabilities applying the following percentages: 40% in 2016 and 20% in 2017. No adjustment would be made in 2018 and later years.
A.26b	Regulatory adjustments applied to CET1 capital in respect of amounts subject to pre-Basel III treatment: available-for-sale reserves	Unrealised gains and losses recognised on the balance sheet should be included as part of CET1. In cases where prior to the introduction of this revised framework banks were permitted to add-back unrealised losses in the calculation of regulatory capital then transitional adjustments may be applied. Under transitional arrangements banks may add back a percentage of any net loss applying the following percentages: 40% in 2016 and 20% in 2017. No adjustment would be made in 2018 and later years.

Item	Description	Guidance
A.27	Regulatory adjustments applied to Common Equity Tier 1 due to insufficient Additional Tier 1 and Tier 2 to cover deductions	To be used where deductions would ordinarily be eligible to be deducted from lower quality capital but cannot be, due to the deduction exceeding the amount of such capital. Where transitional adjustments apply to those items, they also apply to the excess deducted here.
A.28	**Total regulatory adjustments to Common equity Tier 1**	**Automatically completed as the sum of A.7 to A.27 not including sub-category items A.14a, A.23, A.24 and A.25 A.26a and A.26b.**
A.29	**Common Equity Tier 1 capital (CET1)"**	**Automatically completed as A.6 minus A.28**
B	**Additional Tier 1 capital: instruments**	
B.1	Directly issued qualifying Additional Tier 1 instruments plus related stock surplus	Amounts of instruments meeting the qualifying criteria in Annex B that have been issued by the bank itself. Stock surplus (i.e. share premium) that is not eligible for inclusion in Common Equity Tier 1, will only be permitted to be included in Additional Tier 1 capital if the shares giving rise to the stock surplus are permitted to be included in Additional Tier 1 capital.
B.2	of which: classified as equity under applicable accounting standards	B.2 and B.3 are used to report the breakdown of item B.1 into equity and liability items.
B.3	of which: classified as liabilities under applicable accounting standards	
B.4	Directly issued capital instruments subject to phase out from Additional Tier 1	Applies to banks that have issued ineligible preference shares (or other formerly eligible Tier 1 capital). Transitional adjustments apply. Recognition is capped at 60% in 2016 and reduces by 10 percentage points in each subsequent year.

Item	Description	Guidance
B.5	Additional Tier 1 instruments (and CET1 instruments not included in A.5) issued by subsidiaries and held by third parties (amount allowed in AT1)	Applies to banks that own subsidiaries that have issued: AT1 instruments that are held by third parties; or Common share capital that is held by third parties but exceeds the amount eligible in item A.5 (i.e. the amount needed to meet regulatory requirements in respect of CET1 capital). It only applies in the case of prudential reporting submitted on a consolidated basis. The amount allowed is limited to the amount required to meet regulatory requirements in respect of Tier 1 capital. For further guidance, reference should be made to paragraph 63 of the Basel III capital adequacy standard. Where such capital is not eligible for inclusion but was included under the previous rules, then transitional adjustments may be made. 60% of the amount should be excluded on 1 January 2016, 80% on 1 January 2017, and 100% from 1 January 2018 onwards.
B.6	of which: instruments issued by subsidiaries subject to phase out	The amount reported in B.6 that relates to instruments subject to phase out from AT1.
B.7	**Additional Tier 1 capital before regulatory adjustments**	**The sum of B.1, "Directly issued qualifying Additional Tier 1 instruments plus related stock surplus", B.4, "Directly issued capital instruments subject to phase out from Additional Tier 1", and B.5, "Additional Tier 1 instruments (and CET1 instruments not included in A.5) issued by subsidiaries and held by third parties (amount allowed in AT1)"**
B.8	Investments in own Additional Tier 1 instruments	Holdings of own AT1 instruments issued, including any held through consolidated subsidiaries.
B.9	Reciprocal cross-holdings in Additional Tier 1 instruments	Reciprocal cross holdings in AT1 instruments issued by banking, financial and insurance entities.

Item	Description	Guidance
B.10	Investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation, net of eligible short positions, where the bank does not own more than 10% of the issued common share capital of the entity (amount above 10% threshold)	Holdings of AT1 issued by banking, financial and insurance entities (where the bank does not own more than 10% of the issued common share capital of the entity) do not require deduction unless the total of all such amounts exceeds 10% of total CET1, in which case the excess must be deducted here. This uses a proportionate approach – if the investments are a mix of CET1, AT1 and Tier 2 instruments, the amount deducted is the excess of the total above 10%, divided in the same proportions as the holdings. For further guidance, reference should be made to paragraphs 80 to 83 of the Basel III capital adequacy standard.
B.11	Significant investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation (net of eligible short positions)	Where the bank owns AT1 investments in the capital of banking, financial and insurance entities, that are outside the scope of regulatory consolidation, and either:- • The bank owns more than 10% of the issued common share capital of the issuing entity; or • where the entity is an affiliate of the bank (which includes all subsidiaries of the CD bank); then investments must be fully deducted following a corresponding deduction approach. This means the deduction should be applied to the same tier of capital for which the capital would qualify if it was issued by the bank itself. If the bank is required to make a deduction from a particular tier of capital and it does not have enough of that tier of capital to satisfy that deduction, the shortfall will be deducted from the next higher tier of capital. If a bank does not have enough AT1 capital to satisfy the deduction, the shortfall will be deducted from CET1 capital, see item A.19. For further guidance, reference should be made to paragraphs 84 to 86 of the Basel III capital adequacy standard.

Item	Description	Guidance
B.12	National specific regulatory adjustments, including Pillar 2 deductions applied to Additional Tier 1 capital	To be used where deductions are required by the Commission. Typically if any deductions are required in connection with Pillar 2, they would be required to be deducted from CET1 capital in item A.26.
B.13	Regulatory adjustments applied to Additional Tier 1 due to insufficient Tier 2 to cover deductions	To be used where deductions would ordinarily be eligible to be deducted from Tier 2 capital but could not be, due to the deduction exceeding the amount of such capital. Where transitional adjustments apply to those items, they also apply to the excess deducted here.
B.14	**Total regulatory adjustments to Additional Tier 1 capital**	**Automatically completed, being the sum of B.8 to B.13**
B.15	**Additional Tier 1 capital (AT1)"**	**Automatically completed as B.7 minus B.14**
B.16	**Tier 1 capital (T1 = CET1 + AT1)**	**Automatically completed, being the sum of A.29 and B.15**

Item	Description	Guidance
C	**Tier 2 Capital**	
C.1	Directly issued qualifying Tier 2 instruments plus related stock surplus	Amounts of instruments meeting the qualifying criteria in Annex C that have been issued by the bank itself. Stock surplus (i.e. share premium) that is not eligible for inclusion in Tier 1, will only be permitted to be included in Tier 2 capital if the shares giving rise to the stock surplus are permitted to be included in Tier 2 capital.
C.2	Directly issued capital instruments subject to phase out from Tier 2	Subordinated debt (or other formerly eligible Tier 2 capital) issued before revision to the capital adequacy rules subject to transitional adjustments. Transitional adjustments apply. Recognition is capped at 60% in 2016 and reduces by 10 percentage points in each subsequent year.

Item	Description	Guidance
C.3	Tier 2 instruments (and CET1 and AT1 instruments not included in items A.5 or B.5) issued by subsidiaries and held by third parties (amount allowed in group Tier 2)	Applies to banks that own subsidiaries that have issued: • Tier 2 instruments that are held by third parties; or • Common share capital or AT1 instruments that are held by third parties but exceed the amount eligible in Items A.5/B.5 (i.e. the amount needed to meet regulatory requirements in respect of CET1 capital/AT1 capital). It is only proposed to apply this in the case of prudential reporting submitted on a consolidated basis. It is proposed that the amount allowed is limited to the amount required to meet regulatory requirements in respect of total capital, with transitional adjustments applying to any excess. As per Item A.5, the transitional caps permitted for this item are: (1) 40% in 2016 and (2) 20% in 2017. No transitional adjustment applies in 2018 and later years.
C.4	of which: instruments issued by subsidiaries subject to phase out	The amount reported in C.3 that relates to instruments subject to phase out from T2.
C.5	Provisions	Used to report the amount of provisions allowed. Provisions or loan-loss reserves held against future, presently unidentified losses are freely available to meet losses which subsequently materialise and therefore qualify for inclusion within Tier 2. Provisions ascribed to identified deterioration of particular assets or known liabilities, whether individual or grouped, should be excluded. Furthermore, general provisions/general loan-loss reserves eligible for inclusion in Tier 2 will be limited to a maximum of 1.25 percentage points of credit risk-weighted risk assets calculated under the standardised approach.

Item	Description	Guidance
C.6	**Tier 2 capital before regulatory adjustments**	**Automatically completed, being the sum of Item C.1, "Directly issued qualifying Tier 2 instruments plus related stock surplus", Item C.2, "Directly issued capital instruments subject to phase out from Tier 2", Item C.3, "Tier 2 instruments (and CET1 and AT1 instruments not included in rows A.5 or B.5) issued by subsidiaries and held by third parties (amount allowed in group Tier 2)", and Item C.5, "Provisions".**
C.7	Investments in own Tier 2 instruments	Holdings of own Tier 2 instruments issued, including any held through consolidated subsidiaries.
C.8	Reciprocal cross-holdings in Tier 2 instruments	Reciprocal cross holdings in Tier 2 instruments issued by banking, financial and insurance entities.
C.9	Investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation, net of eligible short positions, where the bank does not own more than 10% of the issued common share capital of the entity (amount above the 10% threshold)	Holdings of Tier 2 issued by banking, financial and insurance entities (where the bank does not own more than 10% of the issued common share capital of the entity) do not require deduction unless the total of all such amounts exceeds 10% of total CET1, in which case the excess must be deducted here. This uses a proportionate approach – if the investments are a mix of CET1, AT1 and Tier 2 instruments, the amount deducted is the excess of the total above 10%, divided in the same proportions as the holdings. For further guidance, reference should be made to paragraphs 80 to 83 of the Basel III capital adequacy standard.

Item	Description	Guidance
C.10	Significant investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation (net of eligible short positions)	Where the bank owns Tier 2 investments in the capital of banking, financial and insurance entities, that are outside the scope of regulatory consolidation, and either:- • The bank owns more than 10% of the issued common share capital of the issuing entity; or • where the entity is an affiliate of the bank (which includes all subsidiaries of the CD bank); Then investments must be fully deducted following a corresponding deduction approach. This means the deduction should be applied to the same tier of capital for which the capital would qualify if it was issued by the bank itself. If the bank is required to make a deduction from a particular tier of capital and it does not have enough of that tier of capital to satisfy that deduction, the shortfall will be deducted from the next higher tier of capital. If a bank does not have enough Tier 2 capital to satisfy the deduction, the shortfall will be deducted from AT1 capital, see item B.11. For further guidance, reference should be made to paragraphs 84 to 86 of the Basel III capital adequacy standard.
C.11	National specific regulatory adjustments, including Pillar 2 deductions applied to Tier 2 capital	To be used where deductions are required by the Commission. Typically if any deductions are required in connection with Pillar 2, they would be required to be deducted from CET1 capital in item A.26.
C.12	**Total regulatory adjustments to Tier 2 capital**	**Automatically completed, being the sum of C.7 to C.11**
C.13	**Tier 2 capital (T2)**	**Automatically completed, being the sum of C.6 and C.12.**
C.14	**Total capital (TC = T1 + T2)**	**Automatically completed, being the sum of A.29, B.16 and C.13.**

D	Capital Memorandum Items	
D.1	Non-significant investments in the capital of other financials	Non-significant investments in the capital of other financials, the total amount of such holdings that are not reported in items A.18, B.10 and C.9.

D.2	Significant investments in the common stock of financials	Significant investments in the common stock of financials, the total amount of such holdings that are not reported in item A.19 and A.23.
D.3	Mortgage servicing rights (net of related tax liability)	Mortgage servicing rights, the total amount of such holdings that are not reported in item A.20 and A.24.
D.4	Deferred tax assets arising from temporary differences (net of related tax liability)	Deferred tax assets arising from temporary differences, the total amount of such holdings that are not reported in item A.21 and A.25.
D.5	Provisions eligible for inclusion in Tier 2 in respect of exposures subject to standardised approach (prior to application of cap)	Provisions eligible for inclusion in Tier 2, in respect of exposures subject to standardised approach, prior to the application of the cap.
D.6	Cap on inclusion of provisions in Tier 2 under standardised approach	Cap on inclusion of provisions in Tier 2 under standardised approach, calculated in accordance paragraph 60 of Basel III.
D.7	Provisions eligible for inclusion in Tier 2 in respect of exposures subject to internal ratings-based approach (prior to application of cap)	Provisions eligible for inclusion in Tier 2 in respect of exposures subject to internal ratings-based approach, calculated in accordance paragraph 61 of Basel III, prior to the application of the cap. (Not to be completed where reporting under the standardised approach).
D.8	Current cap on CET1 instruments subject to phase out arrangements	Current cap on CET1 instruments subject to phase out arrangements.
D.9	Amount excluded from CET1 due to cap (excess over cap after redemptions and maturities)	Amount excluded from CET1 due to cap (excess over cap after redemptions and maturities).
D.10	Current cap on AT1 instruments subject to phase out arrangements	Amount excluded from CET1 due to cap (excess over cap after redemptions and maturities).
D.11	Amount excluded from AT1 due to cap (excess over cap after redemptions and maturities)	Amount excluded from CET1 due to cap (excess over cap after redemptions and maturities).

D.12	Current cap on T2 instruments subject to phase out arrangements	Amount excluded from CET1 due to cap (excess over cap after redemptions and maturities).
D.13	Amount excluded from T2 due to cap (excess over cap after redemptions and maturities)	Amount excluded from CET1 due to cap (excess over cap after redemptions and maturities).

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Annex A

Criteria for classification as common shares for regulatory capital purposes

1. Represents the most subordinated claim in liquidation of the bank.
2. Entitled to a claim on the residual assets that is proportional with its share of issued capital, after all senior claims have been repaid in liquidation (i.e. has an unlimited and variable claim, not a fixed or capped claim).
3. Principal is perpetual and never repaid outside of liquidation (setting aside discretionary repurchases or other means of effectively reducing capital in a discretionary manner that is allowable under relevant law).
4. The bank does nothing to create an expectation at issuance that the instrument will be bought back, redeemed or cancelled nor do the statutory or contractual terms provide any feature which might give rise to such an expectation.
5. Distributions are paid out of distributable items (retained earnings included). The level of distributions is not in any way tied or linked to the amount paid in at issuance and is not subject to a contractual cap (except to the extent that a bank is unable to pay distributions that exceed the level of distributable items).
6. There are no circumstances under which the distributions are obligatory. Non-payment is therefore not an event of default.
7. Distributions are paid only after all legal and contractual obligations have been met and payments on more senior capital instruments have been made. This means that there are no preferential distributions, including in respect of other elements classified as the highest quality issued capital.
8. It is the issued capital that takes the first and proportionately greatest share of any losses as they occur. Within the highest quality capital, each instrument absorbs losses on a going concern basis proportionately and pari passu with all the others.
9. The paid in amount is recognised as equity capital (i.e. not recognised as a liability) for determining balance sheet insolvency.
10. The paid in amount is classified as equity under the relevant accounting standards.
11. It is directly issued and paid-in and the bank cannot directly or indirectly have funded the purchase of the instrument.
12. The paid in amount is neither secured nor covered by a guarantee of the issuer or related entity or subject to any other arrangement that legally or economically enhances the seniority of the claim.

13. It is only issued with the approval of the owners of the issuing bank, either given directly by the owners or, if permitted by applicable law, given by the Board of Directors or by other persons duly authorised by the owners.
14. It is clearly and separately disclosed on the bank's balance sheet.

Annex B

Criteria for inclusion in Additional Tier 1 capital

An instrument issued by a bank must meet or exceed the following minimum set of criteria for in order for it to be included in Additional Tier 1 capital.

1. Issued and paid-in.
2. Subordinated to depositors, general creditors and subordinated debt of the bank.
3. Is neither secured nor covered by a guarantee of the issuer or related entity or other arrangement that legally or economically enhances the seniority of the claim vis-à-vis bank creditors.
4. Is perpetual, i.e. there is no maturity date and there are no step-ups or other incentives to redeem.
5. May be callable at the initiative of the issuer only after a minimum of five years.
    - a. To exercise a call option a bank must receive prior supervisory approval; and
    - b. A bank must not do anything which creates an expectation that the call will be exercised; and
    - c. Banks must not exercise a call unless:
        - i. They replace the called instrument with capital of the same or better quality and the replacement of this capital is done at conditions which are sustainable for the income capacity of the bank[1]; or
        - ii. The bank demonstrates that its capital position is well above the minimum capital requirements after the call option is exercised.[2]
6. Any repayment of principal (e.g. through repurchase or redemption) must be with prior supervisory approval and banks should not assume or create market expectations that supervisory approval will be given.
7. Dividend/coupon discretion:
    - a. the bank must have full discretion at all times to cancel distributions/payments
    - b. cancellation of discretionary payments must not be an event of default
    - c. banks must have full access to cancelled payments to meet obligations as they fall due
    - d. cancellation of distributions/payments must not impose restrictions on the bank except in relation to distributions to common stockholders.
8. Dividends/coupons must be paid out of distributable items.
9. The instrument cannot have a credit sensitive dividend feature, that is a dividend/coupon that is reset periodically based in whole or in part on the banking organisation’s credit standing.
10. The instrument cannot contribute to liabilities exceeding assets if such a balance sheet test forms part of national insolvency law[3].
11. Instruments classified as liabilities for accounting purposes must have principal loss absorption through either (i) conversion to common shares at an objective pre-specified trigger point or (ii) a write-down mechanism which allocates losses to the instrument at a pre-specified trigger point. The write-down will have the following effects:
    - a. Reduce the claim of the instrument in liquidation;
    - b. Reduce the amount re-paid when a call is exercised; and

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[1] Replacement issues can be concurrent with but not after the instrument is called.

[2] Minimum refers to the total minimum capital requirement prescribed by the Commission comprising Pillar 1, Pillar 2 and Capital Conservation Buffer.

[3] The instrument cannot contribute to the value of liabilities for the purposes of the solvency test under the Companies (Guernsey) Law, 2008.

c. Partially or fully reduce coupon/dividend payments on the instrument.

The trigger point for write-down/conversion of loss absorbing instruments classified as liabilities must be at least the minimum for Common Equity Tier 1 capital. The write-down/conversion must generate CET1 under the relevant accounting standards and the instrument will only receive recognition in Additional Tier 1 up to the minimum level of CET1 generated by a full write-down/conversion of the instrument. The aggregate amount to be written-down/converted for all such instruments on breaching the trigger level must be at least the amount needed to immediately return the bank's CET1 ratio to the minimum ratio required or, if this is not possible, the full principal value of the instrument.

12. The terms and conditions must have a provision that enables such instruments, at the option of the relevant authority, to either be written off or converted into common equity upon the occurrence of a trigger event, where:
    - any compensation paid to the instrument holders as a result of the write-off must be paid immediately in the form of common stock (or its equivalent in the case of non-joint stock companies);
    - the prior authorisation necessary to immediately issue the relevant number of shares specified in the instrument's terms and conditions should the trigger event occur; and
    - the trigger event is the earlier of: (1) a decision that a write-off, without which the firm would become non-viable, is necessary, as determined by the relevant authority; and (2) the decision to make a public sector injection of capital, or equivalent support, without which the firm would have become non-viable, as determined by the relevant authority.
13. Neither the bank nor a related party over which the bank exercises control or significant influence can have purchased the instrument, nor can the bank directly or indirectly have funded the purchase of the instrument.
14. The instrument cannot have any features that hinder recapitalisation, such as provisions that require the issuer to compensate investors if a new instrument is issued at a lower price during a specified time frame.
15. If the instrument is not issued out of an operating entity or the holding company in the consolidated group (eg a special purpose vehicle – "SPV"), proceeds must be immediately available without limitation to an operating entity[4] or the holding company in the consolidated group in a form which meets or exceeds all of the other criteria for inclusion in Additional Tier 1 capital.

[4] An operating entity is an entity set up to conduct business with clients with the intention of earning a profit in its own right.

Annex C

Criteria for inclusion in Tier 2 Capital

1. Issued and paid-in
2. Subordinated to depositors and general creditors of the bank
3. Is neither secured nor covered by a guarantee of the issuer or related entity or other arrangement that legally or economically enhances the seniority of the claim vis-à-vis depositors and general bank creditors
4. Maturity:
    a. minimum original maturity of at least five years
    b. recognition in regulatory capital in the remaining five years before maturity will be amortised on a straight line basis
    c. there are no step-ups or other incentives to redeem
5. May be callable at the initiative of the issuer only after a minimum of five years:
    a. To exercise a call option a bank must receive prior supervisory approval;
    b. A bank must not do anything that creates an expectation that the call will be exercised[5]; and
    c. Banks must not exercise a call unless:
        i. They replace the called instrument with capital of the same or better quality and the replacement of this capital is done at conditions which are sustainable for the income capacity of the bank[6]; or
        ii. The bank demonstrates that its capital position is well above the minimum capital requirements after the call option is exercised.
6. The investor must have no rights to accelerate the repayment of future scheduled payments (coupon or principal), except in bankruptcy and liquidation.
7. The instrument cannot have a credit sensitive dividend feature, that is a dividend/coupon that is reset periodically based in whole or in part on the banking organisation's credit standing.
8. Neither the bank nor a related party over which the bank exercises control or significant influence can have purchased the instrument, nor can the bank directly or indirectly have funded the purchase of the instrument.
9. If the instrument is not issued out of an operating entity or the holding company in the consolidated group (e.g. a special purpose vehicle – "SPV"), proceeds must be immediately available without limitation to an operating entity or the holding company in the consolidated group in a form which meets or exceeds all of the other criteria for inclusion in Tier 2 Capital.
10. The terms and conditions must have a provision that enables such instruments, at the option of the relevant authority, to either be written off or converted into common equity upon the occurrence of a trigger event, where:
    - Any compensation paid to the instrument holders as a result of the write-off must be paid immediately in the form of common stock (or its equivalent in the case of non-joint stock companies).
    - The prior authorisation necessary to immediately issue the relevant number of shares specified in the instrument's terms and conditions should the trigger event occur.

    For this purpose, a trigger event is the earlier of: (1) a decision that a write-off, without which the firm would become non-viable, is necessary, as determined by the relevant authority; or

[5] An option to call the instrument after five years but prior to the start of the amortisation period will not be viewed as an incentive to redeem as long as the bank does not do anything that creates an expectation that the call will be exercised at this point.

[6] Replacement issues can be concurrent with but not after the instrument is called.

(2) the decision to make a public sector injection of capital, or equivalent support, without which the firm would have become non-viable, as determined by the relevant authority.

Annex D

Transitional Arrangements – Illustrative examples

If an item was £100 million and the transitional adjustment was 60% in 2014 then the adjustment would be £60 million, reported as:

- Value: £60 million;
- Transitional: £100 million; and
- Transitional cap: 60% (the 2014 cap).

The treatment of AT1 and Tier 2 transitional items is more complicated as the amount permitted is not simply reduced; instead it is capped at an amount equal to the relevant (reducing over time) transitional cap percentage multiplied by a fixed amount, being the amount included in capital at a fixed date - 1 January 2013. In this case, the layout provides an additional cell so that full data can be provided.

If a bank's capital included £100 million of preference shares at 1 January 2013 (and this would become ineligible under Basel III) then this amount would be the initial cap. If the transitional cap percentage was 60% in 2016, then up to £60 million could be included. Thus, assuming no change in the item itself, the bank would report, in 2016:

- Value: £60 million (lower of 2016 cap and 2016 amount);
- Transitional: £100 million (2016 amount); and
- Transitional cap: £100 million in the (new) upper cell, 60% in the lower cell (from which the 2016 cap can be seen to be £60 million).

As, for these items, the cap is derived from the original amount, it follows that in the case that the item in the above example reduced from £100 million to £75 million (say, due to a maturity) by 2016, the amount allowed, after transitional adjustments are applied, would not change as this lower value still exceeds the cap. The amounts reported would then be:

- Value: £60 million (lower of 2016 cap and 2016 amount);
- Transitional: £75 million (2016 amount); and
- Transitional cap: £100 million in the upper cell, 60% in the lower cell (from which the 2016 cap can be seen to be £60 million).

In the case that the item in the above example had instead reduced from £100 million to £50 million by 2016, the amount allowed after transitional adjustments are applied would decrease, as this lower value is below the cap, resulting in the full amount being eligible to be included in capital. The amounts reported would then be:

- Value: £50 million (lower of 2016 cap and 2016 amount);
- Transitional: £50 million (2016 amount); and
- Transitional cap: £100 million in the upper cell, 60% in the lower cell (from which the 2016 cap can be seen to be £60 million).

Finally, in the above case where the item reduced from £100 million to £50 million by 2016, if it remained at that level until 2018, the amount allowed after transitional adjustments are applied would decrease as this lower value would then exceed the cap again. The amounts reported would then be:

- Value: £40 million (lower of 2018 cap and 2018 amount);
- Transitional: £50 million (2018 amount); and
- Transitional cap: £100 million in the upper cell, 40% in the lower cell (from which the 2018 cap can be seen to be £40 million).

APPENDIX 3
BSL2 – Module 1 Extract

MODULE 1

STANDARDISED APPROACH TO CREDIT RISK

Item	Nature of Item	Amount	Amount after CRM	Risk Weight	Risk Weighted Amount
J	**Past Due Exposures**				
J.1	Secured				
J.1.1	Risk Weight 0%			0	0
J.1.2	Risk Weight 20%			20	0
J.1.3	Risk Weight 35%			35	0
J.1.4	Risk Weight 50%			50	0
J.1.5	Risk Weight 75%			75	0
J.1.6	Risk Weight 100%			100	0
J.1.7	Risk Weight 150%			150	0
J.2	Unsecured				
J.2.1	Risk Weight 50%			50	0
J.2.2	Risk Weight 100%			100	0
J.2.3	Risk Weight 150%			150	0
	SUBTOTAL	**0**	**0**		**0**
K	**250% and 1,250% weighted items**				
K.1	Significant investments in the common stock of banking, financial and insurance entities			250	0
K.2	Mortgage servicing rights			250	0
K.3	Deferred Tax Assets arising from temporary differences			250	0
K.4	Securitisations - Equity Tranches			1250	0
K.5	Significant investments in commercial entities			1250	0
	SUBTOTAL	**0**	**0**		**0**
L	**Other Balance Sheet Exposures**				
L.1	Tangible Fixed Assets			100	0
L.2	Equity			100	0
L.3	High Risk Assets			150	0
L.4	Other, including Prepayments and Debtors				
L.4.1	Risk Weight 0%			0	0
L.4.2	Risk Weight 20%			20	0
L.4.3	Risk Weight 35%			35	0
L.4.4	Risk Weight 50%			50	0
L.4.5	Risk Weight 75%			75	0
L.4.6	Risk Weight 100%			100	0
L.4.7	Risk Weight 150%			150	0
	SUBTOTAL	**0**	**0**		**0**

Guidance extract:

Portfolio K: 250% and 1,250% weighted items

These items are required to be risk weighted at either 250% or 1,250% as indicated below.

Item	Description of Item	Guidance
K.1	Significant investments in the common stock of banking, financial and insurance entities	Only amounts excluded from deduction under items A.19 and A.22 of Module 6 should be reported here. A 250% risk weighting applies.
K.2	Mortgage servicing rights	Only amounts excluded from deduction under items A.20 and A.22 of Module 6 should be reported here. A 250% risk weighting applies.
K.3	Deferred Tax Assets arising from temporary differences	Only amounts excluded from deduction under items A.21 and A.22 of Module 6 should be reported here. A 250% risk weighting applies.
K.4	Securitisations - equity tranches	Includes all first loss tranches. Also includes tranches rated below BB-, including those with short term ratings of lower than A-3 (or equivalent - see Tables 3 & 4). A 1,250% risk weighting applies.
K.5	Significant investments in commercial entities	The proportion of significant (minority and/or majority) investments in commercial entities exceeding the following materiality levels: (a) 15% of the bank's capital for individual investments in commercial entities; and (b) 60% of the bank's capital for the aggregate of such investments; should be risk weighted at 1,250%. The amount below materiality thresholds should be reported under item L.2.

APPENDIX 4

BSL/2 Module 7

MODULE 7

Item	Description	
F	Risk Weighted Assets	
F.1	Total risk weighted assets	#DIV/0!
F.2	*of which: 250% risk weighted items*	-
F.3	*of which: 1,250% risk weighted items*	-
G	Capital ratios	
G.1	Common Equity Tier 1 (as a percentage of risk weighted assets)	#DIV/0!
G.2	Tier 1 (as a percentage of risk weighted assets)	#DIV/0!
G.3	Total capital (as a percentage of risk weighted assets)	#DIV/0!
G.4	Institution specific Common Equity Tier 1 minimum ratio	
G.5	Institution specific Tier 1 minimum ratio	
G.6	Institution specific total capital minimum ratio	
H	Jurisdictional minima	
H.1	Jurisdictional Common Equity Tier 1 minimum ratio	8.50%
H.2	Jurisdictional Tier 1 minimum ratio	10.50%
H.3	Jurisdictional total capital minimum ratio	10.50%

Guidance extract:

F	**Risk Weighted Assets**	
F.1	Total risk weighted assets	Automatically completed, this is Total Pillar 1 RWA per item E.
F.2	of which: 250% risk weighted items	Automatically completed, this is the amount of RWA relating to 250% risk weighted items.
F.3	of which: 1,250% risk weighted items	Automatically completed, this is the amount of RWA relating to 1,250% risk weighted items.

G	**Capital Ratios**	
G.1	Common Equity Tier 1 (as a percentage of risk weighted assets)	Calculated automatically, this calculates the Common Equity Tier 1 Ratio
G.2	Tier 1 (as a percentage of risk weighted assets)	Calculated automatically, this calculates the Tier 1 Ratio.

G.3	Total capital (as a percentage of risk weighted assets)	Calculated automatically, this calculates the Total Regulatory Capital Ratio.
G.4	Institution specific Common Equity Tier 1 minimum ratio	The institution specific CET1 requirement (jurisdictional minimum including capital conservation buffer plus Pillar 2 add-on) should be entered here in terms of percentage of RWA.
G.5	Institution specific Tier 1 minimum ratio	The institution specific Tier 1 requirement (jurisdictional minimum including capital conservation buffer plus Pillar 2 add-on) should be entered here in terms of percentage of RWA.
G.6	Institution specific total capital minimum ratio	The institution specific Total Regulatory Capital requirement (jurisdictional minimum including capital conservation buffer plus Pillar 2 add-on) should be entered here in terms of percentage of RWA.
H	**Jurisdictional minima**	
H.1	Jurisdictional Common Equity Tier 1 minimum ratio	This item shows the Pillar 1 minimum CET1 requirement including capital conservation buffer.
H.2	Jurisdictional Tier 1 minimum ratio	This item shows the Pillar 1 minimum Tier 1 requirement including capital conservation buffer.
H.3	Jurisdictional total capital minimum ratio	This item shows the Pillar 1 minimum Total Regulatory Capital requirement including capital conservation buffer.

APPENDIX 5

MODULE 11

Leverage ratio reporting template

On-balance sheet exposures		
1	On-balance sheet items (exclude derivatives and SFTs; include collateral)	
2	(Assets deducted in determining Basel III Tier 1 capital)	
3	**Total on-balance sheet exposures** (excluding derivatives and SFTs)	-
Derivative exposures		
4	Replacement cost (net of eligible cash variation margin)	
5	Add-on amount	
6	Gross up for derivatives collateral provided	
7	(Deductions of receivables assets for cash variation margin provided in derivatives transactions)	
8	(Exempted CCP leg of client-cleared trade exposures)	
9	Gross notional credit derivatives sold	
10	(Notional offsets and add-on deductions for written credit derivatives)	
11	**Total derivative exposures**	-
Securities financing transaction exposures		
12	Gross SFT assets (with no recognition of accounting netting), after adjusting for sale accounting transactions	
13	(Netted amounts of cash payables and cash receivables of gross SFT assets)	
14	SFT counterparty exposure	
15	Agent transaction exposures	
16	**Total securities financing transaction exposures**	-
Other off-balance sheet exposures		
17	Off-balance sheet exposure at gross notional amount	
18	Adjustments for conversion to credit equivalent amount	
19	**Other off-balance sheet exposures**	-
Capital and Total Exposures		
20	**Tier 1 capital** (end of reporting period value)	-
21	**Total Exposures** (end of reporting period value)	-
Leverage Ratio		
22	**Basel III leverage ratio (%)**	

APPENDIX 6

MODULE 11

Guidance to completing the Leverage Ratio module of BSL/2

Glossary

The following abbreviations are used within the document:

CCF	Credit Conversion Factors
CCP	Central Counterparty
CM	Clearing Member
MNA	Master Netting Agreement
OBS	Off Balance Sheet
PFE	Potential Future Exposure
QCCP	Qualifying Central Counterparty
RC	Replacement Cost
SFT	Securities Financing Transaction

LEVERAGE RATIO CALCULATION

Module 11, Leverage Ratio Calculation is to be used by locally incorporated banks to calculate and report the Leverage Ratio. The Leverage Ratio is intended as a complementary measure to the risk-based capital adequacy framework under Pillars 1 and 2 and addresses potential model risk and measurement error under Pillar 1 by complementing the risk-based measure with a simple, transparent and independent measure of risk.

Detailed guidance

Item	Description	Guidance
	On-balance sheet exposures	
1	On-balance sheet items (exclude derivatives and SFTs; include collateral)	Report all on-balance sheet assets including on-balance sheet derivative collateral and collateral for securities financing transactions ("SFTs")[7] (but excluding on-balance sheet derivative and SFT assets which are addressed further below)
2	(Assets deducted in determining Basel III Tier 1 capital)	Report on-balance sheet assets deducted from Tier 1 capital. To ensure consistency, on-balance sheet assets deducted from Tier 1 capital (as set out in items A.8 to A.27 and items B.8 to B.13 of Module 6) should be deducted from the Exposure Measure. It should be noted that liability items (e.g. gains and losses due to changes in own credit risk on fair valued liabilities) should not be deducted from the Exposure Measure. This number should be input as a negative number.
3	**Total on-balance sheet exposures (excluding derivatives and SFTs)**	The figure is automatically completed as the sum of items 1 and 2.
	Derivative exposures	

[7] Securities Financing Transactions are transactions such as repurchase agreements, reverse repurchase agreements, security lending and borrowing, and margin lending transactions, where the value of the transactions depend on market valuations and the transactions are often subject to margin agreements.

Item	Description	Guidance
4	Replacement cost (net of eligible cash variation margin)	Report the bank's Replacement Cost ("RC") for all of its derivatives exposures (equivalent to the "Positive Mark-to-Market" element of the Credit Equivalent Amount as calculated under the Standardised Approach to Credit Risk - see section N of Module 1). This figure should be reported net of cash variation margin received. Where an eligible bilateral netting contract is in place, as described in Annex 1 below, then the RC for the set of derivative exposures covered by the contract will be the net replacement cost. Note - Collateral received does not necessarily reduce the economic leverage inherent in a bank's derivatives position and, therefore, as a general rule, collateral received may not be netted against derivatives exposures whether or not netting is permitted under the bank's operative accounting or risk-based framework. When calculating the exposure amount a bank must not reduce the exposure amount by any collateral received from the counterparty. Furthermore, the RC must be grossed up by any collateral amount used to reduce its value, including when collateral received by a bank has reduced the derivatives assets reported on-balance sheet under its operative accounting framework. *Cash variation margin received* - In the case of cash variation margin received, if the conditions listed under guidance for Item 7 are met, the receiving bank may reduce the RC of the exposure amount of the derivative asset by the amount of cash received if the RC of the derivative contract(s) has not already been reduced by the same amount of cash variation margin received under the bank's operative accounting standard.

Item	Description	Guidance
5	Add-on amount	Report the add-on for Potential Future Exposure (equivalent to the "Add-on Amount" element of the Credit Equivalent Amount as calculated under the Standardised Approach to Credit Risk - see section N of Module 1). Where an eligible bilateral netting contract is in place, as described in the Annex below, then the add-on for the set of derivative exposures covered by the contract will be A_{Net} as described in Annex 1. Note - cash variation margin may not be used to reduce the PFE amount.
6	Gross up for derivatives collateral provided	With regard to collateral provided, banks must gross up their exposure measure by the amount of any derivatives collateral provided where the provision of that collateral has reduced the value of their balance sheet assets under their operative accounting framework. Item 6 should be used to report this amount.

7	(Deductions of receivables assets for cash variation margin provided in derivatives transactions)	Report, as a negative number, adjustments permitted regarding the treatment of cash variation margin. In the treatment of derivative exposures for the purpose of the leverage ratio, the cash portion of variation margin exchanged between counterparties may be viewed as a form of pre-settlement payment (and hence not as collateral), if the following conditions are met: (i) For trades not cleared through a qualifying central counterparty (QCCP)[8] the cash received by the recipient counterparty is not segregated. (ii) Variation margin is calculated and exchanged on a daily basis based on mark-to-market valuation of derivatives positions. (iii) The cash variation margin is received in the same currency as the currency of settlement of the derivative contract. (iv) Variation margin exchanged is the full amount that would be necessary to fully extinguish the mark-to-market exposure of the derivative subject to the threshold and minimum transfer amounts applicable to the counterparty. (v) Derivatives transactions and variation margins are covered by a single master netting agreement (MNA) between the legal entities that are the counterparties in the derivatives transaction. The MNA must explicitly stipulate that the counterparties agree to settle net any payment obligations covered by such a netting agreement, taking into account any variation margin received or provided if a credit event occurs involving either counterparty. The MNA must be legally enforceable and effective in all relevant jurisdictions, including in the event of default and bankruptcy or insolvency. In the case of cash variation margin provided to a counterparty, the posting bank may deduct the resulting receivable from its leverage ratio exposure measure, using Item 7, where the cash variation margin has been recognised as an asset under the bank's operative accounting framework.

Item	Description	Guidance
8	(Exempted CCP leg of client-cleared trade exposures)	Report here, as a negative number, certain deductions relating to the treatment of clearing services. Where a bank acting as clearing member (CM)[9] offers clearing services to clients, the clearing member's trade exposures to the central counterparty (CCP) that arise when the clearing member is obligated to reimburse the client for any losses suffered due to changes in the value of its transactions in the event that the CCP defaults, must be captured by applying the same treatment that applies to any other type of derivatives transactions. However, if the clearing member, based on the contractual arrangements with the client, is not obligated to reimburse the client for any losses suffered due to changes in the value of its transactions in the event that a QCCP defaults, the clearing member need not recognise the resulting trade exposures to the QCCP in the leverage ratio exposure measure. Hence it should include the exposure in Items 4 and 5 but enter an offsetting negative amount in Item 8. *Note* - Where a client enters directly into a derivatives transaction with the CCP and the CM guarantees the performance of its clients' derivative trade exposures to the CCP, the bank acting as the clearing member for the client to the CCP must calculate its related leverage ratio exposure resulting from the guarantee as a derivative exposure, as if it had entered directly into the transaction with the client, including with regard to the receipt or provision of cash variation margin, and include the amounts within Items 4 to 7.

[8] A qualifying central counterparty (QCCP) is an entity that is licensed to operate as a central counter party (CCP) (including a license granted by way of confirming an exemption), and is permitted by the appropriate regulator/overseer to operate as such with respect to the products offered. This is subject to the provision that the CCP is based and prudentially supervised in a jurisdiction where the relevant regulator/overseer has established, and publicly indicated that it applies to the CCP on an ongoing basis, domestic rules and regulations that are consistent with the CPSS-IOSCO Principles for Financial Market Infrastructures.

[9] A clearing member is a member of, or a direct participant in, a CCP that is entitled to enter into a transaction with the CCP, regardless of whether it enters into trades with a CCP for its own hedging, investment or speculative purposes or whether it also enters into trades as a financial intermediary between the CCP and other market participants.

Item	Description	Guidance
9	Gross notional credit derivatives sold	Report the full effective notional value[10] referenced by a written credit derivative. This amount is in addition to any exposure amount reported in relation to the same derivative in Items 4, 5 and 6 and represents the credit exposure arising from the credit worthiness of the reference entity.
10	(Notional offsets and add-on deductions for written credit derivatives)	Report a negative amount with amount determined as the sum of: (i) the effective notional amounts which may be reduced by purchased credit protection. The effective notional amount of a written credit derivative may be reduced by the effective notional amount of a purchased credit derivative on the same reference name provided: • the credit protection purchased is on a reference obligation which ranks pari passu with or is junior to the underlying reference obligation of the written credit derivative in the case of single name credit derivatives; and • the remaining maturity of the credit protection purchased is equal to or greater than the remaining maturity of the written credit derivative; (ii) the effective notional amounts, which may be reduced by any negative change in fair value amount that has been incorporated into the calculation of Tier 1 capital with respect to the written credit derivative; and (iii) the individual add-on amount relating to a written credit derivative (not offset by eligible purchased credit protection) reported under Item 5.
11	**Total derivative exposures**	The figure is automatically completed as the sum of Items 4 to 10.
	Securities financing transaction (SFT) exposures	
12	Gross SFT assets (with no recognition of accounting netting), after adjusting for sale accounting transactions	Report gross SFT assets recognised for accounting purposes (i.e. with no recognition of accounting netting) , adjusted to exclude the value of securities received in an SFT where the bank has recognised the securities as an asset on its balance sheet (e.g. under IFRS US GAAP).

[10] The effective notional amount is obtained by adjusting the notional amount to reflect the true exposure of contracts that are leveraged or otherwise enhanced by the structure of the transaction.

Item	Description	Guidance
13	(Netted amounts of cash payables and cash receivables of gross SFT assets)	Report gross SFTs cash payables and cash receivables in SFTs with the same counterparty measured net, if all the following criteria are met: a) Transactions have the same explicit final settlement date; b) The right to set off the amount owed to the counterparty with the amount owed by the counterparty is legally enforceable both currently in the normal course of business and in the event of: (i) default; (ii) insolvency; and (iii) bankruptcy; and c) The counterparties intend to settle net, settle simultaneously, or the transactions are subject to a settlement mechanism that results in the functional equivalent of net settlement, that is, the cash flows of the transactions are equivalent, in effect, to a single net amount on the settlement date. To achieve such equivalence, both transactions are settled through the same settlement system and the settlement arrangements are supported by cash and/or intraday credit facilities intended to ensure that settlement of both transactions will occur by the end of the business day and the linkages to collateral flows do not result in the unwinding of net cash settlement.

Item	Description	Guidance
14	SFT counterparty exposure	This item is used to report a measure of counterparty credit risk as current exposure, to be calculated as follows: • Where no qualifying MNA is in place, the current exposure (E*) for transactions with a counterparty must be calculated on a transaction by transaction basis: that is, each transaction is treated as its own netting set, as shown in the following formula: $E^* = \max \{0, [(E) – (C)]\}$ where E is the total fair value of securities and cash lent and C is the total fair value of cash and securities received under the transaction. • Where a qualifying MNA is in place (see Annex 2) the current exposure (E*) is the greater of zero and the total fair value of securities and cash lent to a counterparty for all transactions included in the qualifying MNA ($\Sigma(E)$) less the total fair value of cash and securities received from the counterparty for those transactions ($\Sigma(C)$). This is illustrated in the following formula: $E^* = \max \{0, [\Sigma(E) – \Sigma(C)]\}$
15	Agent transaction exposures	Report exposures arising where a bank acts as an agent in an SFT and provides a guarantee to a customer or counterparty for any difference between the value of the security or cash the customer has lent and the value of collateral the borrower has provided. This exposure should be calculated using the same methodology as that used for Item 14.
16	**Total securities financing transaction exposures**	Automatically completed as the sum of Items 12 to 15.
	Other off-balance sheet exposures	
17	Off-balance sheet exposure at gross notional amount	Report total off-balance sheet ("OBS") exposure on a gross notional basis, before any adjustment for credit conversation factors according to item 18.

Item	Description	Guidance
18	Adjustments for conversion to credit equivalent amount	Report a negative amount representing the reduction in gross amount of OBS exposures due to the application of credit conversion factors (“CCFs”). The CCFs are those that apply under the Standardised Approach to Credit Risk (Module M), except that they are subject to a floor of 10% (applicable to Commitments that are unconditionally cancellable without prior notice, see Module M, item M9c).
19	Other off-balance sheet exposures	The figure is automatically completed as the sum of Items 17 and 18
	Capital and Total Exposures	
20	Tier 1 capital (end of reporting period value)	Used to report Tier 1 capital. The figure is automatically completed from Item B.16 in Module 6.
21	Total Exposures (end of reporting period value)	Automatically completed as the sum of Items 3, 11, 16 and 19.
	Leverage Ratio	
22	Basel III leverage ratio (%)	Automatically completed as Item 20 divided by Item 21 with the ratio expressed as a percentage.

ANNEX 1

Bilateral netting

1. For the purposes of the leverage ratio, the following will apply:

   a) Banks may net transactions subject to novation under which any obligation between a bank and its counterparty to deliver a given currency on a given value date is automatically amalgamated with all other obligations for the same currency and value date, legally substituting one single amount for the previous gross obligations.

   b) Banks may also net transactions subject to any legally valid form of bilateral netting not covered in (a), including other forms of novation.

   c) In both cases (a) and (b), a bank will need to satisfy the Commission that it has:
      (i) a netting contract or agreement with the counterparty that creates a single legal obligation, covering all included transactions, such that the bank would have either a claim to receive or obligation to pay only the net sum of the positive and negative mark-to-market values of included individual transactions in the event a counterparty fails to perform due to any of the following: default, bankruptcy, liquidation or similar circumstances;

(ii) written and reasoned legal opinions that, in the event of a legal challenge, the relevant courts and administrative authorities would find the bank's exposure to be such a net amount under:
   - the law of the jurisdiction in which the counterparty is chartered and, if the foreign branch of a counterparty is involved, then also under the law of jurisdiction in which the branch is located;
   - the law that governs the individual transactions; and
   - the law that governs any contract or agreement necessary to effect the netting.

   The Commission, after consultation when necessary with other relevant supervisors, must be satisfied that the netting is enforceable under the laws of each of the relevant jurisdictions; and

(iii) procedures in place to ensure that the legal characteristics of netting arrangements are kept under review in the light of possible changes in relevant law.

2. Contracts containing walkaway clauses will not be eligible for netting for the purpose of calculating the leverage ratio requirements pursuant to this framework. A walkaway clause is a provision that permits a non-defaulting counterparty to make only limited payments, or no payment at all, to the estate of a defaulter, even if the defaulter is a net creditor.

3. Credit exposure on bilaterally netted forward transactions will be calculated as the sum of the net mark-to-market replacement cost, if positive, plus an add-on based on the notional underlying principal. The add-on for netted transactions (A_{Net}) will equal the weighted average of the gross add-on (A_{Gross}) and the gross add-on adjusted by the ratio of net current replacement cost to gross current replacement cost (NGR). This is expressed through the following formula:

$$A_{Net} = 0.4 \cdot A_{Gross} + 0.6 \cdot NGR \cdot A_{Gross}$$

   where:

   NGR = level of net replacement cost/level of gross replacement cost for transactions subject to legally enforceable netting agreements

   A_{Gross} = sum of individual add-on amounts (calculated by multiplying the notional principal amount by the appropriate add-on factors set out in section N of Module 1) of all transactions subject to legally enforceable netting agreements with one counterparty.

4. For the purposes of calculating potential future credit exposure to a netting counterparty for forward foreign exchange contracts and other similar contracts in which the notional principal amount is equivalent to cash flows, the notional principal is defined as the net receipts falling due on each value date in each currency. The reason for this is that offsetting contracts in the same currency maturing on the same date will have lower potential future exposure as well as lower current exposure.

ANNEX 2

Qualifying master netting agreement: the effects of bilateral netting agreements covering repo-style transactions will be recognised on a counterparty-by-counterparty basis if the agreements are legally enforceable in each relevant jurisdiction upon the occurrence of an event of default and regardless of whether the counterparty is insolvent or bankrupt. In addition, netting agreements must:

a) provide the non-defaulting party with the right to terminate and close out in a timely manner all transactions under the agreement upon an event of default, including in the event of insolvency or bankruptcy of the counterparty;

b) provide for the netting of gains and losses on transactions (including the value of any collateral) terminated and closed out under it so that a single net amount is owed by one party to the other;

c) allow for the prompt liquidation or setoff of collateral upon the event of default; and

d) be, together with the rights arising from provisions required in (a) and (c) above, legally enforceable in each relevant jurisdiction upon the occurrence of an event of default regardless of the counterparty's insolvency or bankruptcy.

Netting across positions in the banking book and trading book will only be recognised when the netted transactions fulfil the following conditions:

a) All transactions are marked to market daily, and

b) The collateral instruments used in the transactions are recognised as eligible financial collateral in the banking book.

APPENDIX 7

Hypothetical example of Pillar 2 add-on adjustment following implementation of revision to Pillar 1 capital requirement

Example Bank 1 has a current total minimum regulatory capital requirement of 12% of RWA comprising an 8% Pillar 1 charge and a 4% Pillar 2 add-on (currently described as a 150% ICG). The bank ICAAP identified that the Pillar 1 assessment of capital required for credit risk and operational risk was insufficient. Additional capital of 1% of RWA was assessed to address each respective risk. Additional capital of 2% of RWA was assessed to address reputational risk. These amounts were adopted as regulatory guidance by the SREP.

Under the new regime the Pillar 1 minimum total regulatory capital requirement will be 10.5% of RWA (including the conservation buffer). If the current Pillar 2 add-on of 4% is maintained then the bank would be required to meet a 14.5% regulatory requirement. Given that the Pillar 1 requirement has effectively increased by 2.5% it can be argued that there is double-counting of risk in relation to the Pillar 2 add-ons relating to Pillar 1 risks i.e. the 2% relating to credit and operational risk. In this example following review by the Commission the Pillar 2 assessment could be revised downward by up to 2%, resulting in a total regulatory minimum capital requirement of 12.5% RWA.

Example Bank 2 has a current total minimum regulatory capital requirement of 10% of RWA comprising an 8% Pillar 1 charge and a 2% Pillar 2 add-on (currently described as a 125% ICG). The bank ICAAP identified that the Pillar 1 assessment of capital required for credit risk was insufficient and additional capital of 2% of RWA was assessed to address this risk. This amount was adopted as regulatory guidance by the SREP.

Under the new regime the Pillar 1 minimum total regulatory capital requirement will be 10.5% of RWA (including the conservation buffer). If the current Pillar 2 add-on of 2% is maintained then the bank would be required to meet a 12.5% regulatory requirement. Given that the Pillar 1 requirement has effectively increased by 2.5% it can again be argued that there is double-counting of risk in relation to the Pillar 2 add-ons relating to Pillar 1 risks i.e. the 2% relating to credit risk. In this example following review by the Commission the Pillar 2 assessment could be revised downward, subject to the new 10.5% Pillar 1 minimum requirement and the 0.5% floor on Pillar 2. Revision could result, therefore, in a total regulatory minimum capital requirement of 11% RWA.

APPENDIX 8

Illustrative example of Pillar 2 guidance format

Pillar 2 guidance will generally be set using the following format:

Total Regulatory Capital Requirement =

Pillar 1 8% of RWA + CCB 2.5% of RWA + Bank Specific Pillar 2 Add-on X% of RWA

Alternatively, in circumstances where a specific Pillar 2 risk is identified and quantified, and is static in nature i.e. the related capital requirement would not be sensitive to movement in the bank's RWA, then the Total Regulatory Capital Requirement may be set using the following format:

Pillar 1 8% of RWA + CCB 2.5% of RWA + Bank Specific Pillar 2 Add-on Y% of RWA + £Z

where Z represents a fixed amount of capital to meet a specific Pillar 2 risk.