

CAPITAL ADEQUACY RETURN

A GUIDANCE NOTES

1. The following notes and definitions apply specifically to the Capital Adequacy Return.

In the event of any difficulties in completing this return, please contact the Banking Trust & Investment Department at the Authority on the telephone number below or speak to your normal point of contact.

Telephone: 295-5278

Coverage

2. In particular, this return should include all the assets, liabilities and off-balance sheet items of the reporting institution or of the consolidated group (for coverage see notes 3 & 4 below) and not only those related to Bermuda.
3. This return is to be completed as at the end of March, June, September and December each year by institutions licensed under the Banks and Deposit Companies Act 1999 on an unconsolidated and consolidated basis.
4. The companies to be included in the consolidation will be those agreed between the reporting institution and the Bermuda Monetary Authority (the Authority) in accordance with the Authority's paper on Consolidated Supervision.

Valuation

5. Outstanding liabilities and holdings of assets should normally be reported at the value outstanding in the reporting institution's books (i.e. book value), in accordance with the reporting institution's usual accounting practices. For positions held in the Trading book, the reporting institution should report on a Mark to Market basis. For off-balance sheet items (contingents, guarantees, acceptances, etc) the principal amount should be shown. For valuation of interest and exchange rate contracts see the definitions for items 520 and 530.

Specific provisions

6. All loans, advances, bills and securities are to be included in this return net of any specific or earmarked general provisions made.

Off-balance sheet items should also be reported net of specific provisions. However, the amount of such provisions should be included in item 770.

Accruals

7. In general, the return should be completed on an accrual rather than a cash basis. Such accruals should be shown, where possible, against the relevant category of counterparty for assets or under item 320 for accruals not specifically identified. Accruals on liabilities should be included under item 770.

Maturity of assets and off-balance sheet items

8. Certain on and off-balance sheet items are to be reported according to their maturity. The reporting requirements for this return are on the basis of a residual maturity of one year or less or more than one year. Reporting institutions with overseas offices may discuss the implications of this requirement with the Authority if the reporting of exactly one year maturities are treated differently in the countries in which they are operating.

Original/residual maturity

Off-balance sheet commitments should be reported according to their original maturity.

Analysis of Categories

9. For each category of on and off balance sheet item there is a breakdown of the total into different weighting bands, i.e. 0%, 10%, 20%, 50% or 100%, depending on the risk weight attributed to the counterparties. The following summary list identifies the counterparty weights and also lists credit conversion factors for off-balance sheet risk. It is not a full list of all on and off-balance sheet items, e.g. cash is not shown here (see Capital Adequacy Return Definitions for a full list of items and for more detail generally):

0% weighting

- (i) cash and claims collateralised by cash deposits placed with the lending institution (or CDs and similar instruments issued by and lodged with the reporting institution)
- (ii) gold and other bullion held in own vaults or on an allocated basis
- (iii) claims on Zone A central governments and central banks
- (iv) claims carrying the explicit guarantee of Zone A central governments or central banks
- (v) claims on Zone B central governments or central banks denominated in the local currency and funded by liabilities in the same currency

- (vi) claims guaranteed by Zone B central governments or central banks, where denominated in local currency and funded in that currency
- (vii) certificates of tax deposit

10% weighting

- (i) holdings of fixed interest securities issued or guaranteed by Zone A central governments with a residual maturity of 1 year or less, and floating rate and index-linked securities of any maturity issued or guaranteed by Zone A central governments
- (ii) claims collateralised by Zone A central government fixed interest securities with a maturity of 1 year or less, and similar floating rate or index-linked securities of any maturity
- (iii) holdings of securities issued by Zone B central governments with a residual maturity of 1 year or less and denominated in local currency and funded by liabilities in the same currency.

20% weighting

- (i) holdings of fixed interest securities issued or guaranteed by Zone A central governments with a residual maturity of over 1 year
- (ii) claims collateralised by Zone A central government fixed interest securities with a residual maturity of over 1 year
- (iii) holdings of Zone B central government securities with a maturity of over 1 year denominated in local currency and funded by liabilities in the same currency
- (iv) claims on multilateral development banks and claims guaranteed by or collateralised by securities issued by these institutions – comprising: African Development Bank; Asian Development Bank; Caribbean Development Bank; European Bank for Reconstruction and Development; European Investment Bank; European Investment Fund; Inter-American Development Bank; Inter-American Investment Corporation; International Bank for Reconstruction and Development; International Finance Corporation; and Nordic Investment Bank.
- (v) claims on credit institutions incorporated in Zone A countries and claims guaranteed (or accepted or endorsed) by Zone A incorporated credit institutions
- (vi) claims on credit institutions incorporated in Zone B with a residual maturity of 1 year or less and claims of the same maturity guaranteed by Zone B credit institutions
- (vii) claims on Zone A public sector entities and claims guaranteed by such entities

- (viii) claims on authorised investment firms subject to the EU Capital Adequacy Directive or a broadly equivalent regime
- (ix) claims on (or directly and unconditionally guaranteed by) certain clearing houses and exchanges, including initial cash margins and surplus variation margins at futures exchanges or clearing houses
- (x) cash items in the process of collection

50% weighting

- (i) loans to individuals fully secured by a first priority charge on residential property that is (or is to be) occupied by the borrower or rented
- (ii) loans to housing associations which are fully secured by a first priority charge on the housing association residential property which is being rented
- (iii) mortgage sub-participations where the risk to the sub-participating bank is fully and specifically secured against residential mortgage loans which would themselves qualify for the 50% weight
- (iv) items in suspense

100% weighting

- (i) claims on the non-bank private sector
- (ii) claims on credit institutions incorporated in Zone B countries with a residual maturity of over 1 year
- (iii) claims on (or guaranteed by) Zone B central governments and central banks (unless denominated in the national currency and funded by liabilities in the same currency)
- (iv) claims on Zone B regional governments, local authorities and public sector entities
- (v) claims on commercial entities owned by the public sector
- (vi) premises, plant, equipment and other fixed assets
- (vii) real estate, trade investments and other assets not otherwise specified
- (viii) aggregate net short open foreign exchange position
- (ix) gross deferred tax assets
- (x) Other assets

Credit Conversion Factors for Off-Balance Sheet Risk

Credit conversion factors should be multiplied by the weights applicable to the category of the counterparty for an on-balance sheet transaction. The calculation is: nominal principal x credit conversion factor x counterparty weighting.

100% credit conversion factor

- (i) direct credit substitutes, including general guarantees of indebtedness, standby letters of credit serving as financial guarantees, acceptances and endorsements
- (ii) Sale and repurchase agreements and asset sales with recourse, where the credit risk remains with the reporting institution
- (iii) forward asset purchases, forward deposits placed and the unpaid portion of partly paid shares and securities, together with any other commitments with a certain draw-down

50% credit conversion factor

- (i) transaction-related contingent items not having the character of direct credit substitutes (e.g. performance bonds, bid bonds, warranties and standby letters of credit related to particular transactions)
- (ii) note issuance facilities and revolving underwriting facilities
- (iii) other commitments with an original maturity of over 1 year (e.g. formal standby facilities and credit lines)

20% credit conversion factor

- (i) short-term self-liquidating trade-related contingent items (e.g. documentary credits collateralised by the underlying shipments)

Zero credit conversion factor

- (i) endorsements of bills (including per aval endorsements) which have previously been accepted by a bank
- (ii) other commitments (e.g. formal standby facilities and credit lines) with an original maturity of up to 1 year or which can be unconditionally cancelled at any time

OTC derivative contracts

When entering into over the counter interest rate, foreign exchange rate, equity, precious metal (other than gold) and other commodity contracts, banks are exposed to the counterparty risk in the form of the potential cost of replacing any positive cash flows. The risk varies depending on the maturity of the contract and on the volatility of the underlying rate or price. Such exposures are treated in a similar way to other off-balance sheet contracts, calculating the proportion of the nominal exposure considered to be at risk – the credit equivalent amount.

Replacement cost

The credit equivalent amount of these instruments is calculated by adding together:

- (a) the total replacement cost of all contracts with a positive value (i.e. marking to market); and
- (b) an amount for potential future credit exposure (calculated as a percentage of the notional principal amount), reflecting the residual maturity of the contract:

See definitions for item 530-533 in the Capital Adequacy Return definition for detailed guidance on using the replacement cost method.

No future credit exposure should be calculated for single currency interest rate basis swaps; the credit exposure on these contracts should be evaluated solely on the basis of mark to market value.

10. Certain assets may be entered in the “unanalyzed” boxes at the foot of each of the main categories on the return. This is meant to provide for, for example those situations where the difficulty which certain reporting institutions would face in providing a breakdown by counterparty type would be substantial compared to the benefit received from a weighting lower than 100%, e.g. where a major institution has a category of assets or an overseas branch(es) which represents an insignificant part of the institution’s overall assets.

Investment trusts/Unit trusts/Mutual funds

11. Equity holdings in investment trusts and holdings of “units” in unit trusts or mutual funds will normally attract the highest risk weighting of 100%. However, when the assets held by the investment institution are legally restricted to assets of a lower weight (e.g. by articles of association or loan documentation) then a holding will be weighted at that lower weight. If a range of lower weighted assets are included in a fund or trust a holding will be weighted at the highest of these weights. Holdings in entities established to hold capital instruments issued by banks will normally be deducted from capital (see definition of item 230).

Zone A / Zone B

12. The term “Zone A” covers full members of the OECD and those countries which have concluded special lending arrangements with the IMF associated with the IMF’s General Arrangements to Borrow, provided they have not rescheduled their external sovereign debt to official or private sector creditors, in the previous 5 years.

This group of countries is extended automatically to include any new countries which join the OECD, provided they meet the rescheduling criterion, from their date of admission. Zone A countries now comprise:

Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany (including any pre-reunification claims on East Germany), Greece, Hungary, Iceland, Ireland, Italy, Japan, South Korea, Luxembourg, Mexico, Netherlands, New Zealand, Norway, Poland, Portugal, Saudi Arabia, Spain, Sweden, Switzerland, Turkey, United Kingdom and United States.

Bermuda, Gibraltar, the Channel Islands and the Isle of Man should also be regarded as Zone A countries.

The reporting institution should discuss with the Authority the appropriate treatment of other dependencies of Zone A countries.

Zone B comprises all countries not in Zone A.

For the purpose of determining whether a bank is in Zone A or B, the place of incorporation is the relevant factor to be considered rather than location of branch. For example, a loan made to a branch located in a Zone A country of a Zone B incorporated bank should be classified as a loan to a Zone B bank.

Central banks

13. Central banks should exclude the following Eastern European foreign trade banks (FTBs):

Bulgaria	Bulgarian Foreign Trade Bank
Czechoslovakia	Ceskoslovenska Obchodni Banka
Hungary	Hungarian Foreign Trade Bank
Poland	Bank Handlowy w Warszawie
Romania	Romanian Bank of Foreign Trade
Former Soviet Union	Bank for Foreign Economic Affairs

Reporting institutions may however classify FTBs as Zone B banks if they so wish, and should notify the Authority if they do so.

Central governments

14. Comprises all departments, establishments and bodies of a central government located in its domestic territory performing government functions, together with the embassies, consulates and military establishments of the government located elsewhere.

Banks

15. The term “bank” as used in this return refers to those institutions that are regarded as banks or equivalent deposit-taking institutions in the countries in which they are incorporated and are supervised by the appropriate banking supervisory or monetary authority as banks.

In the USA, banks are referred to as depository institutions which include branches of federally-insured banks and depository institutions chartered and head-quartered in the 50 states of the United States, the District of Columbia, Puerto Rico, and US territories and possessions. The definition encompasses banks, mutual or stock savings banks, savings or building and loans associations, co-operative banks and credit unions; it excludes bank holding companies (other than those which are themselves banks).

Multilateral Development Banks (MDBs)

16. Only the following institutions are classified as MDBs for the purpose of this return:

International Bank for Reconstruction and Development (IBRD): “World Bank”
International Finance Corporation (IFC)
Inter-American Development Bank (IADB)
Asian Development Bank (AsDB)
African Development Bank (AfDB)
European Investment Bank (EIB)
European Investment Fund (EIF)
Caribbean Development Bank (CDB)
Nordic Investment Bank (NIB)
European Bank for Reconstruction and Development (EBRD)
Council of Europe Resettlement Fund
Inter-American Investment Corporation (IIC)

Financial Companies/institutions

17. A financial company/institution is an undertaking, other than a bank, whose principal business involves:
 - (i) Lending including inter alia

- consumer credit
 - mortgage credit
 - factoring, with or without recourse
 - financing of commercial transactions (including forfeiting)
- (ii) Financial leasing
 - (iii) Money transmission services
 - (iv) Issuing and administering means of Payment (e.g. credit cards, travellers' cheques and bankers' drafts)
 - (v) Guarantees and commitments
 - (vi) Trading for own account or for the account of customers in:
 - (a) money market instruments (cheques, bills, CDs etc)
 - (b) foreign exchange
 - (c) financial futures and options
 - (d) exchange and interest rate instruments
 - (e) transferable securities
 - (vii) Participation in share issues and provision of services related to such issues.
 - (viii) Advice to undertakings on capital structure, industrial strategy and related questions and advice and services relating to mergers and acquisitions.
 - (ix) Money broking
 - (x) Portfolio management and advice
 - (xi) Safekeeping and administration of securities

Group companies

18. The definition used in this return of "group companies" in relation to a company covers:
- (i) its parent company and any co-subsidiaries of that parent;
 - (ii) its subsidiaries; and
 - (iii) other companies in which such companies hold 20% or more of the voting rights or ordinary share capital.

Related parties

19. Related parties are defined as: other group companies (see Guidance Note 18 above), excluding those companies which are included in the consolidation of this particular return; directors, controllers and their associates; and non-group companies with which directors and controllers are associated.

A pension fund or other trust fund of the group should not necessarily be classified as related for the purposes of this return. However, it should be treated as a related party if a director/controller of the reporting institution is both a director of the fund and is involved in decision-making on whether or not an exposure to that fund should be undertaken.

Directors, controllers, and their associates are as defined in Section 7 of the Banks and Deposit Companies Act 1999.

In addition, a director (including an alternate director) or controller of the reporting institution is deemed to be associated with another company, whether registered or resident in Bermuda or overseas, if he holds the office of a director (or alternative director) with that company (whether in his own right, or as a result of a loan granted to, or financial interest taken in, that company by the reporting institution, or even by virtue of a professional interest unconnected with the reporting institution), or if he and/or his associates together hold 10% or more of the equity share capital of that company. For the purpose of this item, include as a director an employee of the reporting institution who is not a director but who is appointed a director of another company. (This definition should be consistent with that adopted for Large Exposure Reporting.)

Public Sector Entities (PSEs)

20. Principally regional governments and local authorities, but bodies which carry out non-commercial functions on behalf of, and are responsible to, regional governments or local authorities may also be classified as PSEs. Also include bodies owned by the central or regional government or local authorities which perform regulatory or other non-commercial functions. Commercial entities or companies (other than banks) owned by the public sector, including public utilities, should be classified as “other” and carry a weighting of 100%.

Small Business Development Corporation, Bermuda Housing Corporation, West End Development Co. and Bermuda Land Development Co. should also be regarded as Public Sector entities.

Treasury Bills should be reported under investments, item 180, in the category best meeting its description.

Collateral

21. Where claims on a counterparty are collateralised by cash (see Guidance Note 22) or by securities or bills issued by Zone A central governments, Zone A central banks or multilateral development banks (see Guidance Note 15), a lower risk weight may apply. The risk weight category under which the claim should be reported is determined by the nature of the collateral, as follows:

0%	Cash (see Note 22)
10%	Zone A central government and central bank treasury bills and fixed interest securities (including index-linked securities) of a residual maturity of 1 year or less or similar floating rate securities of any maturity.
20% (i)	Zone A central government and central bank fixed interest securities (including index-linked securities) of a residual maturity of over 1 year;
(ii)	Multilateral development banks' securities.

If the value of the collateral covers less than the book value of the asset, only that part of the asset which is fully covered may receive the appropriate lower weight. Securities used as collateral must be marked-to-market except where otherwise agreed with the Authority. No other forms of collateral may reduce a risk weighting.

For collateralised off-balance sheet exposures (other than interest, exchange rate, equity, precious metals and commodity contracts) the value of the collateral should be set against the nominal value of the exposure before calculating the credit equivalent amount. For an exposure to be fully covered the collateral must at least equal 100% of the nominal value of the exposure (not of any smaller credit equivalent amount). For example, where cash collateral covers 75% of a nominal exposure, first the collateral should be applied to the nominal principal leaving an uncovered exposure of 25%. The appropriate credit conversion factor should then be applied to this uncovered portion. The full nominal value of collateralised off-balance sheet exposure should be reported on the Capital Adequacy Return in the risk weighting bands to reflect collateral.

For interest and exchange rate contracts however the value of collateral should be compared to the credit equivalent amount. Where collateral fully covers this amount the risk weighting may be reduced accordingly; where collateral covers only part of the credit equivalent amount only the part that is fully covered may receive the appropriate lower weight.

Where lower risk weights have been applied to reflect collateral, enter the relevant amounts in the Capital Adequacy Return.

Cash Collateral

22. Where exposures which do not meet the rules for set-off (see Guidance Note 23) are collateralised by cash, i.e. balances held with the reporting institution denominated in Bermuda dollars, foreign currency or gold, or CDs issued by the reporting institution and lodged with it, such exposures should be reported under the relevant item in the 0% band.

For these purposes an exposure is collateralised by cash only if the cash is held by the reporting institution for the account of the depositor/customer on express terms such that:

- (i) the cash may not be withdrawn for the duration of the exposure; and
- (ii) the reporting institution may apply the cash to discharge the exposure if and to the extent that it is not discharged by the borrower/customer in accordance with the terms of the loan etc. agreement with the borrower/customer.

In the case of an exposure partially collateralised by cash only that part of the exposure which is fully collateralised should be reported in the 0% weight band.

To qualify as cash collateral:

- (i) The customer(s) and the office(s) of the reporting institution or group company(ies) involved in the transaction(s) must have “local resident” status, i.e. they must all be resident in the same country.
- (ii) In the case of the reporting institution’s *unconsolidated* return:
 - (a) the cash must be held with the reporting institution;
 - (b) the reporting institution should have a right of set-off over the cash which is legally enforceable in a liquidation of the debtor.
- (iii) In the case of a reporting institution’s *consolidated* return:
 - (a) the cash must be held with the company which has the exposure;
 - (b) where the lending institution is a Bermuda office of a Bermuda incorporated company, it should have a right of set-off over the cash which is legally enforceable in a liquidation of the debtor;
 - (c) where the lending institution is incorporated overseas or is an overseas branch of a Bermuda incorporated company it should have a first charge over cash held with itself where this is enforceable in the local legal jurisdiction or other equivalent security interest or a right of set-off over the cash which is legally enforceable in a liquidation of the debtor.

Netting

23. *On-balance sheet*

Debit balances on accounts with the reporting bank may only be offset against credit balances on other accounts with that bank where all the following criteria are met:

- (a) there is formal agreement with the customer(s) to do so, or where a legal right of set-off exists. Such arrangements should, to the best of the reporting institution's knowledge, be enforceable in a liquidation of the customer(s);
- (b) both the debit and credit balances are denominated in the same currency. Thus, for example, a debit balance in Bermuda dollars may not be offset against a credit balance in another currency.
- (c) the debit and credit balances relate to the same customer, or to customers in the same company group, e.g. a parent company and its subsidiary. For a group facility, the facility should be advised in the form of a net amount and controlled by the reporting institution on that basis. Such an arrangement should be preferably supported by a full cross guarantee structure;
- (d) the customer(s) involved in the transaction(s) giving rise to the credit and debit balances has local resident status. Local residents are those customers of the reporting institution which are resident in the same country as the office of the reporting institution in whose books the credit and debit balances appears. No set-off is allowed in respect of balances relating to non-local customers, even if one of the parties is a local resident. Where more than one office of the reporting institution is involved in the transactions, the offices should also be in the same country.

Off-balance sheet

Pending further consideration, net amounts due in respect of foreign exchange transactions may be reported only if the net amount derived is pursuant to the application of a bilateral agreement (between two counterparties) based upon netting by novation. Netting by novation is where obligations between counterparties to deliver given amounts on a given date are automatically amalgamated with all other obligations to deliver the same currency on the same value date and netted. Such netting should have the effect of legally discharging performances of the original obligation and substituting the single net amount as the sole remaining obligation between the parties for the relevant value date.

Long and short positions in Investments

24. In certain circumstances long positions in securities may be offset against short positions for the purposes of calculating the weighted amount. The gross amounts should be recorded under items 180-250 (long positions) and under item 770 (short positions). Additionally, short positions in central government and central bank securities should be reported under item 380 and will attract a risk weight.

The conditions to be satisfied for netting of long and short positions are:

- (a) *Central governments and central banks*

Netting of long and short positions will only be permitted if the following criteria are all met:

- (i) the long and short positions are in securities issued by the same central government or bank;
- (ii) the long and short positions are in securities dominated in the same currency;
- (iii) the long and short positions are in fixed rate securities within the same maturity time band, i.e. one year or less (10% risk weight) or over one year (20% risk weight). Similarly, index-linked securities may only be offset against each other if they are within the same maturity time band. Floating rate securities of any maturity can be offset against each other but no netting of floating rate securities against fixed rate or index-linked securities will be permitted.

Both the gross and net long positions in central government and central bank securities should be reported under item 180, with the net long positions attracting the relevant risk weights. Gross short positions should be reported under item 770 with the next short positions being reported under item 380.

A simplified reporting example is set out below (the netting criteria are met for securities A and B but not C):

	Long position	Short position	Net
US government security A	100	-	100
US government security B	-	(50)	(50)
US government security C	5	(25)	(20)
	105	(75)	
Gross long position (item 180)	=	105 i.e. sum of individual long positions	

Gross short position (item 770)	=	(75) i.e. sum of individual short positions
Net long position (item 180)	=	[100 + (50)] = 50 i.e. sum of net long positions after netting gross positions permitted by (i) to (iii) above (in this case the netting of positions in A and B)
Net short position (item 320)	=	(20) i.e. sum of net short positions after netting of gross positions as permitted by (i) to (iii) above (in this case none)

(b) *Other Securities*

Report gross positions, net only of short positions in the same security issue.

Warrants and convertibles should not be offset against the underlying equity into which they may convert.

Guarantees

25. (a) Guarantees received

Claims that have been explicitly, irrevocably and unconditionally guaranteed by those counterparties listed below may be weighted according to the risk weight of the guarantor where the effect is to reduce the weighting; such guarantees should be legally enforceable. Where a claim is partially guaranteed only that part of the claim which is fully guaranteed will be weighted according to the risk weight of the guarantor. Only direct guarantees of a bank's claims are recognised. Guarantees of a counterparty's assets, or general guarantees of its financial position, are insufficient in themselves to merit a reduced risk weighting. The notes in this section apply to the instruments serving as guarantees and insurance/indemnities discussed below as well as to guarantees.

Instruments serving as guarantees

Apart from traditional bank guarantees, certain other financial instruments (e.g. a letter of credit or standby letter of credit, a purchased put option that may be exercised at any time, and a risk participation) may be regarded as guarantees as long as they provide the same comfort as a guarantee, ie they must provide an explicit, irrevocable and unconditional obligation to pay a third party beneficiary when a customer fails to repay an outstanding loan or to meet a financial obligation (including contingent obligations).

Insurance / Indemnities

Where a claim is covered for all risks by an insurance policy, or where an indemnity is explicit, irrevocable and unconditional, reduced weighting may also be appropriate; such claims should be discussed on a case by case basis with the Authority.

Guarantees received from subsidiaries

No account should be taken of a guarantee received by the reporting institution from a subsidiary when determining the risk weight of an asset of the parent bank, unless collateralised by a cash deposit placed with that subsidiary.

Risk weighting

On and off-balance sheet items subject to guarantees should still be reported in the same counterparty category rather than that of the guarantor but shown in the weighting band relative to the guarantor. For example, a loan to a non-bank customer which is guaranteed by a Zone A incorporated bank should be reported in item 150.3 instead of 150.4, and not in item 120. The relevant risk weights are as follows:

- | | | |
|-----|-------|---|
| 0% | (i) | Zone A central governments and central banks (other than securities guaranteed); |
| | (ii) | Zone B central governments and central banks (other than securities guaranteed) where the claim being guaranteed is denominated in the local currency of the guarantor and borrower and funded in that currency. |
| 10% | (i) | Fixed rate securities, guaranteed by Zone A central governments and central banks, which have a residual maturity of 1 year or less; |
| | (ii) | Floating rate securities of any maturity guaranteed by Zone A central governments and central banks; |
| | (iii) | Any securities, guaranteed by Zone B central governments and central banks, which have a residual maturity of 1 year or less and are denominated in the local currency of the guarantor and issuer and funded in that currency. |
| 20% | (i) | Fixed rate securities, guaranteed by Zone A central governments and central banks, which have a residual maturity of over 1 year; |
| | (ii) | Any securities, guaranteed by Zone B central governments and central banks, which have a residual maturity of over 1 year and |

are denominated in the local currency of the guarantor and issuer and funded in that currency;

- (iii) Multilateral development banks;
- (iv) Banks incorporated in Zone A countries;
- (v) Banks incorporated in Zone B countries, where the claim being guaranteed has a residual maturity of 1 year or less;
- (vi) Zone A public sector entities.

Holdings of bank capital instruments which carry a central government or central bank guarantee should be deducted from capital in accordance with the definition of item 230.

Guarantees of swaps etc

Guarantees of swaps etc will be acceptable for reducing the risk weighting of an item where they meet the above criteria, where the reporting institution receiving the guarantee calculates daily the mark-to-market valuation of the asset being guaranteed and where the guarantee is valued at the current mark-to-market value of the contract plus “add-ons” (see definitions to items 520/530).

Guarantees of a capital nature

See the definitions section (item 410) for details.

Where lower risk weights have been applied, enter the relevant amounts.

- (b) Guarantees given

Joint and several guarantees given by the reporting institution

Where the reporting institution has guaranteed an exposure jointly and severally with other institutions, its share of the guarantee (as explicitly defined or otherwise equal to the total value of the guarantee divided by the number of guarantors) should be reported as an exposure on the counterparty and the balance of the guarantee as an exposure on the other guarantors.

Sale and Repurchase Agreements (“repos”)

26. *Repos*

Reporting institutions that have sold loans or other assets to other institutions for a finite period with a commitment to repurchase should continue to report the loan

or asset on the balance sheet. Where this is not the reporting institution's normal accounting practice, sale and repurchase agreements should be reported in the off-balance sheet section of the return.

Reverse Repos

Reporting institutions which have purchased such loans or assets (i.e. purchase and resale agreements or reverse repos) should for the duration of the agreement report the transaction as a collateralised loan, adopting the normal weight for the counterparty unless the assets are eligible for a reduced weight (e.g. government securities).

Stock lending / borrowing as a principal

27. When a reporting institution has entered into a stock lending agreement as principal the stock lent should continue to be reported as an asset on its balance sheet. No exposure in respect of the counterparty in the transaction should be reported.

When an institution has entered into a stock borrowing transaction as principal the reporting treatment will depend upon the type of collateral given.

If the collateral given is cash, the exposure should be treated as a collateralised loan to the counterparty. If the securities borrowed by the reporting institution qualify as eligible collateral then a lower risk weighting may be applied accordingly.

If the collateral given is not cash, then the reporting institution should continue to report the collateral given on its own balance sheet. No exposure to the counterparty should be reported.

“Disguised” credit exposure in interest and exchange rate contracts

28. The arrangement of certain contracts may include an element of “disguised” credit exposure.

In general, the Authority would consider a disguised credit exposure to be present where the contract either starts with a significantly positive mark-to-market value, or, on an assumption of unchanged interest and exchange rates, is designed at some time in its life to have a significantly positive mark-to-market value. (Institutions should discuss with the Authority what constitutes such mark-to-market value).

The reporting institution should contact the Authority to agree on suitable reporting where it has such contracts. In general, the Authority will require the

disguised credit exposure to be reported separately from the swap in a manner fixed at the outset of the contract. For example:

- (a) the up-front payment on a swap at off-market rates should be reported as a loan in items 100-160, and amortised over the life of the swap;
- (b) a staggered exchange of principal, where the reporting institution has paid away its side and has not yet received the counterparty's side, should be reported as a loan in items 100-160.

Where the disguised credit exposure is reported separately as in the above examples, the mark-to-market value of the swap as reported in Appendix 1 should exclude the disguised credit exposure reported as above.

Where a reporting institution has a contract that gives rise to a “disguised” credit exposure on itself for its counterparty (e.g. receiving interest quarterly and paying interest annually), the reporting institution should report the contract as normal.

Participations/Syndications

29. Where the reporting institution transfers a loan by *novation*, *assignment* or through a *sub-participation*, that part of the loan transferred should not be reported. In a *sub-participation*, where the reporting institution acts as a manager or co-manager, deposits received from the other participating institutions (representing their shares of the amounts to be lent) should not be included under deposits, nor should their shares of the loan be included in assets.

Where the reporting institution buys all or part of a loan from another institution, it should report its holding as an advance to the borrower and not as lending to the institution from which it has purchased the loan.

If the reporting institution has transferred undrawn commitments to lend (or part of them), the commitment (or part) should not be reported when the transfer is either by *novation*, or by an *assignment* accompanied by a formal acknowledgement from the borrower. A transfer by means of *silent assignment* or *sub-participation* should be reported as a commitment in the off-balance section of the return with the counterparty risk assigned to the buyer of the commitment. The buyer of a commitment (or part) should report in the off-balance section under the relevant counterparty weight of the borrower, irrespective of the method of transfer used.