Subsidiary Legislation made under ss.55C, 620, 621, 626 and 626A.

Financial Services (Capital Requirements) (Technical Standards) Regulations 2026

LN.2026/020

Commencement **1.2.2026**

ARRANGEMENT OF REGULATIONS

Regulation

1. Title.
2. Commencement.
3. Technical Standards.
4. Revocations.

ANNEX
CAPITAL REQUIREMENTS TECHNICAL STANDARDS

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

In exercise of the powers conferred on the Minister by sections 55C, 620, 621, 626 and 626A of the Financial Services Act 2019, the Minister has made these Regulations-

Title.

1. These Regulations may be cited as the Financial Services (Capital Requirements) (Technical Standards) Regulations 2026.

Commencement.

2. These Regulations come into operation on 1st February 2026.

Technical Standards.

3. The Capital Requirements Technical Standards, set out in the Annex to these Regulations, have effect.

Revocations.

4. The following instruments, so far as they form part of the law of Gibraltar, are revoked–

(a) Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012;

(b) Commission Delegated Regulation (EU) No 241/2014 of 7 January 2014 supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards for Own Funds requirements for institutions;

(c) Commission Delegated Regulation (EU) No 1187/2014 of 2 October 2014 supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council as regards regulatory technical standards for determining the overall exposure to a client or a group of connected clients in respect of transactions with underlying assets;

(d) Commission Delegated Regulation (EU) 2015/61 of 10 October 2014 to supplement Regulation (EU) No 575/2013 of the European Parliament and the Council with regard to liquidity coverage requirement for Credit Institutions;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(e) Commission Delegated Regulation (EU) 2016/101 of 26 October 2015 supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards for prudent valuation under Article 105(14);

(f) Commission Delegated Regulation (EU) 2016/709 of 26 January 2016 supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards specifying the conditions for the application of the derogations concerning currencies with constraints on the availability of liquid assets;

(g) Commission Delegated Regulation (EU) 2017/208 of 31 October 2016 supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards for additional liquidity outflows corresponding to collateral needs resulting from the impact of an adverse market scenario on an institution's derivatives transactions.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

ANNEX

CAPITAL REQUIREMENTS TECHNICAL STANDARDS

PART 1
GENERAL PROVISIONS

TITLE 1
SUBJECT MATTER, SCOPE AND DEFINITIONS

CHAPTER 1
GENERAL PROVISIONS

1. Scope.
2. Supervisory powers.
3. Application of stricter requirements by institutions.
4. Definitions.
5. Definitions specific to capital requirements for credit risk.

TITLE 2
LEVEL OF APPLICATION OF REQUIREMENTS

CHAPTER 1
APPLICATION OF REQURIEMENTS ON AN INDIVIDUAL BASIS

6. General principles.
7. Derogation from the application of prudential requirements on an individual basis.
8. Derogation from the application of liquidity requirements on an individual basis.
9. Individual consolidation method.
10. [Not used].
10A. Application of prudential requirements on a consolidated basis where investment firms are parent undertakings.

CHAPTER 2
PRUDENTIAL CONSOLIDATION

Application of requirements on a consolidated basis

11. General treatment.
12. [Not used]
12A. Consolidated calculation for G-SIIs with multiple resolution entities.
13. Application of disclosure requirements on a consolidated basis.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

14. Application of requirements of Article 5 of the Securitisation Regulation on a consolidated basis.
15. to 17. [Not used]

Methods for prudential consolidation

18. Methods of prudential consolidation.

Scope of prudential consolidation

19. Entities excluded from the scope of prudential consolidation.
20. Decisions on prudential requirements.
21. [Not used]
22. Sub-consolidation in cases of entities in third countries.
23. Undertakings in third countries.
24. Valuation of assets and off-balance sheet items.

PART 2
OWN FUNDS AND ELIGIBLE LIABILITIES

TITLE 1
ELEMENTS OF OWN FUNDS

CHAPTER 1
TIER 1 CAPITAL

25. Tier 1 capital.

CHAPTER 2
COMMON EQUITY TIER 1 CAPITAL

Common Equity Tier 1 items and instruments

26. Common Equity Tier 1 items.
27. Capital instruments of mutuals, cooperative societies, savings institutions or similar institutions in Common Equity Tier 1 items.
28. Common Equity Tier 1 instruments.
29. Capital instruments issued by mutuals, cooperative societies, savings institutions and similar institutions.
30. Consequences of the conditions for Common Equity Tier 1 instruments ceasing to be met.
31. [Not used]

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Prudential filters

32. Securitised assets.
33. Cash flow hedges and changes in the value of own liabilities.
34. Additional value adjustments.
35. Unrealised gains and losses measured at fair value.

Deductions from Common Equity Tier 1 items, exemptions and alternatives

36. Deductions from Common Equity Tier 1 items.
37. Deduction of intangible assets.
38. Deduction of deferred tax assets that rely on future profitability.
39. Tax overpayments, tax loss carry backs and deferred tax assets that do not rely on future profitability.
40. Deduction of negative amounts resulting from the calculation of expected loss amounts.
41. Deduction of defined benefit pension fund assets.
42. Deduction of holdings of own Common Equity Tier 1 instruments.
43. Significant investment in a financial sector entity.
44. Deduction of holdings of Common Equity Tier 1 instruments of financial sector entities and where an institution has a reciprocal cross holding designed artificially to inflate own funds.
45. Deduction of holdings of Common Equity Tier 1 instruments of financial sector entities.
46. Deduction of holdings of Common Equity Tier 1 instruments where an institution does not have a significant investment in a financial sector entity.
47. Deduction of holdings of Common Equity Tier 1 instruments where an institution has a significant investment in a financial sector entity.
47A. [Not used]
47B. Forbearance measures.
47C. [Not used]
48. Threshold exemptions from deduction from Common Equity Tier 1 items.
49. Requirement for deduction where consolidation or supplementary supervision is applied.
50. Common Equity Tier 1 capital.

CHAPTER 3
ADDITIONAL TIER 1 CAPITAL

Additional Tier 1 items and instruments

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

51. Additional Tier 1 items.
52. Additional Tier 1 instruments.
53. Restrictions on the cancellation of distributions on Additional Tier 1 instruments and features that could hinder the recapitalisation of the institution.
54. Write down or conversion of Additional Tier 1 instruments.
55. Consequences of the conditions for Additional Tier 1 instruments ceasing to be met.

Deductions from Additional Tier 1 items

56. Deductions from Additional Tier 1 items.
57. Deductions of holdings of own Additional Tier 1 instruments.
58. Deduction of holdings of Additional Tier 1 instruments of financial sector entities and where an institution has a reciprocal cross holding designed artificially to inflate own funds.
59. Deduction of holdings of Additional Tier 1 instruments of financial sector entities.
60. Deduction of holdings of Additional Tier 1 instruments where an institution does not have a significant investment in a financial sector entity.

Additional Tier 1 capital

61. Additional Tier 1 capital.

CHAPTER 4
Tier 2 capital

Tier 2 items and instruments

62. Tier 2 items.
63. Tier 2 instruments.
64. Amortisation of Tier 2 instruments.
65. Consequences of the conditions for Tier 2 instruments ceasing to be met.

Deductions from Tier 2 items

66. Deductions from Tier 2 items.
67. Deductions of holdings of own Tier 2 instruments.
68. Deduction of holdings of Tier 2 instruments of financial sector entities and where an institution has a reciprocal cross holding designed artificially to inflate own funds.
69. Deduction of holdings of Tier 2 instruments of financial sector entities.
70. Deduction of Tier 2 instruments where an institution does not have a significant investment in a relevant entity.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Tier 2 capital

71. Tier 2 capital.

CHAPTER 5
OWN FUNDS

72. Own funds.

CHAPTER 5A
ELIGIBLE LIABILITIES

Deductions from eligible liabilities items

72A. Eligible liabilities items.
72B. Eligible liabilities instruments.
72C. Amortisation of eligible liabilities instruments.
72D. Consequences of the eligibility conditions ceasing to be met.

Deductions from eligible liabilities items

72E. Deductions from eligible liabilities items.
72F. Deduction of holdings of own eligible liabilities instruments.
72G. Deduction base for eligible liabilities items.
72H. Deduction of holdings of eligible liabilities of other G-SII entities.
72I. Deduction of eligible liabilities where the institution does not have a significant investment in G-SII entities.
72J. Trading book exception from deductions from eligible liabilities items.

Own funds and eligible liabilities

72K. Eligible liabilities.
72L. Own funds and eligible liabilities

CHAPTER 6
GENERAL REQUIREMENTS FOR OWN FUNDS AND ELIGIBLE LIABILITIES

73. Distributions on instruments.
74. Holdings of capital instruments issued by regulated financial sector entities that do not qualify as regulatory capital.
75. Deduction and maturity requirements for short positions.
76. Index holdings of capital instruments.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

77. Conditions for reducing own funds and eligible liabilities.
78. Supervisory approval to reduce own funds.
78A. Approval to reduce eligible liabilities instruments.
79. Temporary waiver from deduction from own funds and eligible liabilities.
79A. Assessment of compliance with the conditions for own funds and eligible liabilities instruments.
80. [Not used]

TITLE 2
MINORITY INTEREST AND ADDITIONAL TIER 1 AND TIER 2 INSTRUMENTS ISSUED BY SUBSIDIARIES

81. Minority interests that qualify for inclusion in consolidated Common Equity Tier 1 capital.
82. Qualifying Additional Tier 1, Tier 1, Tier 2 capital and qualifying own funds.
83. [Not used]
84. Minority interests included in consolidated Common Equity Tier 1 capital.
85. Qualifying Tier 1 instruments included in consolidated Tier 1 capital.
86. Qualifying Tier 1 capital included in consolidated Additional Tier 1 capital.
87. Qualifying own funds included in consolidated own funds.
88. Qualifying own funds instruments included in consolidated Tier 2 capital.

TITLE 3
QUALIFYING HOLDINGS OUTSIDE THE FINANCIAL SECTOR

89. Risk weighting and prohibition of qualifying holdings outside the financial sector.
90. Alternative to 1,250% risk weight.
91. Exceptions.

PART 3
CAPITAL REQUIREMENTS

TITLE 1
GENERAL REQUIREMENTS, VALUATION AND REPORTING

CHAPTER 1
REQUIRED LEVEL OF OWN FUNDS

Own funds requirements for institutions

92. Own funds requirements.
92A. Requirements for own funds and eligible liabilities for G-SIIs.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

92B. Requirement for own funds and eligible liabilities for third-country G-SIIs.
93. Initial capital requirement on going concern.
94. [Not used]

Own funds requirements for investment firms with limited authorisation to provide investment services

95. Own funds requirements for investment firms with limited authorisation to provide investment services.
96. Own funds requirements for Regulation 19(2) investment firms.
97. Own Funds based on Fixed Overheads.
98. Own funds for investment firms on a consolidated basis.

Calculation and reporting requirements

99. to 101. [Not used]

Trading book

102. Requirements for the trading book.
103. Management of the trading book.
104. Inclusion in the trading book.
104A. Reclassification of a position.
104B. Requirements for trading desk.
105. Requirements for prudent valuation.
106. Internal Hedges.

TITLE 2
CAPITAL REQUIREMENTS FOR CREDIT RISK

CHAPTER 1
GENERAL PRINCIPLES

107. Approaches to credit risk.
108. Use of credit risk mitigation technique under the Standardised Approach and the IRB Approach.
109. Treatment of securitisation positions.
110. Treatment of credit risk adjustment.

CHAPTER 2
STANDARDISED APPROACH

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

General principles

111. Exposure value.
112. Exposure classes.
113. Calculation of risk-weighted exposure amounts.

Risk weights

114. Exposures to central governments or central banks.
115. Exposures to regional governments or local authorities.
116. Exposures to public sector entities.
117. Exposures to multilateral development banks.
118. Exposures to international organisations.
119. Exposures to institutions.
120. Exposures to rated institutions.
121. Exposures to unrated institutions.
122. Exposures to corporates.
123. Retail exposures.
124. Exposures secured by mortgages on immovable property.
125. Exposures fully and completely secured by mortgages on residential property.
126. Exposures fully and completely secured by mortgages on commercial immovable property.
127. Exposures in default.
128. Items associated with particular high risk.
129. Exposures in the form of covered bonds.
130. Items representing securitisation positions.
131. Exposures to institutions and corporates with a short-term credit assessment.
132. Exposures in the form of units or shares in CIUs.
132A. Approaches for calculating risk-weighted exposure amounts of CIUs.
132B. Exclusions from the approaches for calculating risk-weighted exposure amounts of CIUs.
132C. Treatment of off-balance-sheet exposures to CIUs.
133. Equity exposures.
134. Other items.

Recognition and mapping of credit risk assessment

135. Use of credit assessments by ECAIs.
136. [Not used]
137. Use of credit assessments by export credit agencies.
138. General requirements.
139. Issuer and issue credit assessment.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

140. Long-term and short-term credit assessments.
141. Domestic and foreign currency items.

CHAPTER 3
INTERNAL RATINGS BASED APPROACH

142. Definitions.
143. Approval to use the IRB Approach.
144. GFSC's assessment of an application to use an IRB Approach.
145. Prior experience of using IRB approaches.
146. Measures to be taken where the requirements of this Chapter cease to be met.
147. Methodology to assign exposures to exposure classes.
148. Conditions for implementing the IRB Approach across different classes of exposure and business units.
149. Conditions to revert to the use of less sophisticated approaches.
150. Conditions for permanent partial use.

Calculation of risk-weighted exposure amounts

151. Treatment by exposure class.
152. Treatment of exposures in the form of units or shares in CIUs.
153. Risk-weighted exposure amounts for exposures to corporates, institutions and central governments and central banks.
154. Risk-weighted exposure amounts for retail exposures.
155. Risk-weighted exposure amounts for equity exposures.
156. Risk-weighted exposure amounts for other non credit-obligation assets.
157. Risk-weighted exposure amounts for dilution risk of purchased receivables.

Expected loss amounts

158. Treatment by exposure type.
159. Treatment of expected loss amounts.

PD, LGD and maturity

160. Probability of default (PD).
161. Loss Given Default (LGD).
162. Maturity.
163. Probability of default (PD).
164. Loss Given Default (LGD).
165. Equity exposures subject to the PD/LGD method.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Exposure value

166. Exposures to corporates, institutions, central governments and central banks and retail exposures.
167. Equity exposures.
168. Other non credit-obligation assets.

Requirements for the IRB approach

169. General principles.
170. Structure of rating systems.
171. Assignment to grades or pools.
172. Assignment of exposures.
173. Integrity of assignment process.
174. Use of models.
175. Documentation of rating systems.
176. Data maintenance.
177. Stress tests used in assessment of capital adequacy.
178. Default of an obligor.
179. Overall requirements for estimation.
180. Requirements specific to PD estimation.
181. Requirements specific to own-LGD estimates.
182. Requirements specific to own-conversion factor estimates.
183. Requirements for assessing the effect of guarantees and credit derivatives for exposures to corporates, institutions and central governments and central banks where own estimates of LGD are used and for retail exposures.
184. Requirements for purchased receivables.
185. Validation of internal estimates.
186. Own funds requirement and risk quantification.
187. Risk management process and controls.
188. Validation and documentation.
189. Corporate Governance.
190. Credit risk control.
191. Internal Audit.

CHAPTER 4
CREDIT RISK MITIGATION

192. Definitions.
193. Principles for recognising the effect of credit risk mitigation techniques.
194. Principles governing the eligibility of credit risk mitigation techniques.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Eligible forms of credit risk mitigation

195. On-balance sheet netting.
196. Master netting agreements covering repurchase transactions or securities or commodities lending or borrowing transactions or other capital market-driven transactions.
197. Eligibility of collateral under all approaches and methods.
198. Additional eligibility of collateral under the Financial Collateral Comprehensive Method.
199. Additional eligibility for collateral under the IRB Approach.
200. Other funded credit protection.
201. Eligibility of protection providers under all approaches.
202. Eligibility of protection providers under the IRB Approach which qualify for the treatment set out in Article 153(3).
203. Eligibility of guarantees as unfunded credit protection.
204. Eligible types of credit derivatives.
204A. Eligible types of equity derivatives.

Requirements

205. Requirements for on-balance sheet netting agreements other than master netting agreements referred to in Article 206.
206. Requirements for master netting agreements covering repurchase transactions or securities or commodities lending or borrowing transactions or other capital market driven transactions.
207. Requirements for financial collateral.
208. Requirements for immovable property collateral.
209. Requirements for receivables.
210. Requirements for other physical collateral.
211. Requirements for treating lease exposures as collateralised.
212. Requirements for other funded credit protection.
213. Requirements common to guarantees and credit derivatives.
214. Sovereign and other public sector counter-guarantees.
215. Additional requirements for guarantees.
216. Additional requirements for credit derivatives.
217. Requirements to qualify for the treatment set out in Article 153(3).

Calculating the effects of credit risk mitigation

218. Credit linked notes.
219. On-balance sheet netting.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

220. Using the Supervisory Volatility Adjustments Approach or the Own Estimates Volatility Adjustments Approach for master netting agreements.
221. Using the internal models approach for master netting agreements.
222. Financial Collateral Simple Method.
223. Financial Collateral Comprehensive Method.
224. Supervisory volatility adjustment under the Financial Collateral Comprehensive Method.
225. Own estimates of volatility adjustments under the Financial Collateral Comprehensive Method.
226. Scaling up of volatility adjustment under the Financial Collateral Comprehensive Method.
227. Conditions for applying a 0% volatility adjustment under the Financial Collateral Comprehensive Method.
228. Calculating risk-weighted exposure amounts and expected loss amounts under the Financial Collateral Comprehensive method.
229. Valuation principles for other eligible collateral under the IRB Approach.
230. Calculating risk-weighted exposure amounts and expected loss amounts for other eligible collateral under the IRB Approach.
231. Calculating risk-weighted exposure amounts and expected loss amounts in the case of mixed pools of collateral.
232. Other funded credit protection.
233. Valuation.
234. Calculating risk-weighted exposure amounts and expected loss amounts in the event of partial protection and tranching.
235. Calculating risk-weighted exposure amounts under the Standardised Approach.
236. Calculating risk-weighted exposure amounts and expected loss amounts under the IRB Approach.

Maturity mismatches

237. Maturity mismatch.
238. Maturity of credit protection.
239. Valuation of protection.

Basket CRM techniques

240. First-to-default credit derivatives.
241. Nth-to-default credit derivatives.
242. Definitions.
243. Criteria for STS securitisations qualifying for differentiated capital treatment.

Recognition of significant risk transfer

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

244. Traditional securitisation.
245. Synthetic securitisation.
246. Operational requirements for early amortisation provisions.

Calculation of risk-weighted exposure amounts

247. Calculation of risk-weighted exposure amounts.
248. Exposure value.
249. Recognition of credit risk mitigation for securitisation positions.
250. Implicit support.
251. Originator institutions' calculation of risk-weighted exposure amounts securitised in a synthetic securitisation.
252. Treatment of maturity mismatches in synthetic securitisations.
253. Reduction in risk-weighted exposure amounts.
254. Hierarchy of methods.
255. Determination of K IRB and K SA.
256. Determination of attachment point (A) and detachment point (D).
257. Determination of tranche maturity (M T).
258. Conditions for the use of the Internal Ratings Based Approach (SEC-IRBA).
259. Calculation of risk-weighted exposure amounts under the SEC-IRBA.
260. Treatment of STS securitisations under the SEC-IRBA.
261. Calculation of risk-weighted exposure amounts under the Standardised Approach (SEC-SA).
262. Treatment of STS securitisations under the SEC-SA.
263. Calculation of risk-weighted exposure amounts under the External Ratings Based Approach (SEC-ERBA).
264. Treatment of STS securitisations under the SEC-ERBA.
265. Scope and operational requirements for the Internal Assessment Approach.
266. Calculation of risk-weighted exposure amounts under the Internal Assessment Approach.
267. Maximum risk weight for senior securitisation positions– look-through approach.
268. Maximum capital requirements.
269. Re-securitisations.
270. Senior positions in SME securitisations.
270A. Additional risk weight.

External credit assessments

270B. Use of credit assessments by ECAIs.
270C. Requirements to be met by the credit assessments of ECAIs.
270D. Use of credit assessments.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

270E. [Not used]

CHAPTER 6
COUNTERPARTY CREDIT RISK

Definitions

271. Determination of the exposure value.
272. Definitions.

Methods for calculating the exposure value

273. Methods for calculating the exposure value.
273A. Conditions for using simplified methods for calculating the exposure value.
273B. Non-compliance with the conditions for using simplified methods for calculating the exposure value of derivatives.

Standardised approach for counterparty credit risk

274. Exposure value.
275. Replacement cost.
276. Recognition and treatment of collateral.
277. Mapping of transactions to risk categories.
277A. Hedging sets.
278. .Potential future exposure.
279. Calculation of the risk position.
279A. Supervisory delta.
279B. Adjusted notional amount.
279C. Maturity factor.
280. Hedging set supervisory factor coefficient.
280A. Interest rate risk category add-on.
280B. Foreign exchange risk category add-on.
280C. Credit risk category add-on.
280D. Equity risk category add-on.
280E. Commodity risk category add-on.
280F. Other risks category add-on.

Simplified standardised approach for counterparty credit risk

281. Calculation of the exposure value.

Original exposure method

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

282. Calculation of the exposure value.

Internal model method

283. Approval to use the Internal Model Method.
284. Exposure value.
285. Exposure value for netting sets subject to a margin agreement.
286. Management of CCR - Policies, processes and systems.
287. Organisation structures for CCR management.
288. Review of CCR management system.
289. Use test.
290. Stress testing.
291. Wrong-way risk.
292. Integrity of the modelling process.
293. Requirements for the risk management system.
294. Validation requirements.

Contractual netting

295. Recognition of contractual netting as risk-reducing.
296. Recognition of contractual netting agreements.
297. Obligations of institutions.
298. Effects of recognition of netting as risk-reducing.

Items in the trading book

299. Items in the trading book.

Own funds requirements for exposures to a central counterparty

300. Definitions.
301. Material scope.
302. Monitoring of exposures to CCPs.
303. Treatment of clearing members' exposures to CCPs.
304. Treatment of clearing members' exposures to clients.
305. Treatment of clients' exposures.
306. Own funds requirements for trade exposures.
307. Own funds requirements for contributions to the default fund of a CCP.
308. Own funds requirements for pre-funded contributions to the default fund of a QCCP.
309. Own funds requirements for pre-funded contributions to the default fund of a non-qualifying CCP and for unfunded contributions to a non-qualifying CCP.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

310. Own funds requirements for unfunded contributions to the default fund of a QCCP.
311. Own funds requirements for exposures to CCPs that cease to meet certain conditions.

TITLE 3
OWN FUNDS REQUIREMENTS FOR OPERATIONAL RISK

CHAPTER 1
GENERAL PRINCIPLES GOVERNING THE USE OF THE DIFFERENT APPROACHES

312. Approval and notification.
313. Reverting to the use of less sophisticated approaches.
314. Combined use of different approaches.

CHAPTER 2
BASIC INDICATOR APPROACH

315. Own funds requirement.
316. Relevant indicator.

CHAPTER 3
STANDARDISED APPROACH

317. Own funds requirement.
318. Principles for business line mapping.
319. Alternative Standardised Approach.
320. Criteria for the Standardised Approach.

CHAPTER 4
ADVANCED MEASUREMENT APPROACHES

321. Qualitative standards.
322. Quantitative Standards.
323. Impact of insurance and other risk transfer mechanisms.
324. Loss event type classification.

TITLE 4
OWN FUNDS REQUIREMENTS FOR MARKET RISK

CHAPTER 1
GENERAL PROVISIONS

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

325. Approaches for calculating the own funds requirements for market risk.
325A. Exemptions from specific reporting requirements for market risk.
325B. Approval for consolidated requirements.

CHAPTER 1A
ALTERNATIVE STANDARDISED APPROACH

General provisions

325C. Scope and structure of the alternative standardised approach.

Sensitivities-based method for calculating the own funds requirements

325D. Definitions.
325E. Components of the sensitivities-based method.
325F. Own funds requirements for delta and vega risks.
325G. Own funds requirements for curvature risk.
325H. Aggregation of risk-class specific own funds requirements for delta, vega and curvature risks.
325I. Treatment of index instruments and multi-underlying options.
325J. Treatment of collective investment undertakings.
325K. Underwriting positions.

Risk factor and sensitivity definitions

325L. General interest rate risk factors.
325M. Credit spread risk factors for non-securitisation.
325N. Credit spread risk factors for securitisation.
325O. Equity risk factors.
325P Commodity risk factors.
325Q. Foreign exchange risk factors.
325R. Delta risk sensitivities.
325S. Vega risk sensitivities.
325T. Requirements on sensitivity computations.

The residual risk add-on

325U. Own funds requirements for residual risks.

Own funds requirements for the default risk

325V. Definitions and general provisions.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

325W. Gross jump-to-default amounts.
325X. Net jump-to-default amounts.
325Y. Calculation of the own funds requirements for the default risk.
325Z. Jump-to-default amounts.
325AA. Calculation of the own funds requirement for the default risk for securitisations.
325AB. Scope.
325AC. Jump-to-default amounts for the ACTP.
325AD. Calculation of the own funds requirements for the default risk for the ACTP.

Risk weights and correlations

325AE. Risk weights for general interest rate risk.
325AF. Intra bucket correlations for general interest rate risk.
325AG. Correlations across buckets for general interest rate risk.
325AH. Risk weights for credit spread risk for non-securitisations.
325AI. Intra-bucket correlations for credit spread risk for non-securitisations.
325AJ. Correlations across buckets for credit spread risk for non-securitisations.
325AK. Risk weights for credit spread risk for securitisations included in the ACTP.
325AL. Correlations for credit spread risk for securitisations included in the ACTP.
325AM. Risk weights for credit spread risk for securitisations not included in the ACTP.
325AN. Intra-bucket correlations for credit spread risk for securitisations not included in the ACTP.
325AO. Correlations across buckets for credit spread risk for securitisations not included in the ACTP.
325AP. Risk weights for equity risk.
325AQ. Intra-bucket correlations for equity risk.
325AR. Correlations across buckets for equity risk.
325AS. Risk weights for commodity risk.
325AT. Intra-bucket correlations for commodity risk.
325AU. Correlations across buckets for commodity risk.
325AV. Risk weights for foreign exchange risk.
325AW. Correlations for foreign exchange risk.
325AX. Vega and curvature risk weights.
325AY. Vega and curvature risk correlations.

CHAPTER 1B
ALTERNATIVE INTERNAL MODEL APPROACH

Approval and own funds requirements

325AZ. Alternative internal model approach and approval to use alternative internal models.
325BA. Own funds requirements when using alternative internal models.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

General requirements

325BB. Expected shortfall risk measure.
325BC. Partial expected shortfall calculations.
325BD. Liquidity horizons.
325BE. Assessment of the modellability of risk factors.
325BF. Regulatory back-testing requirements and multiplication factors.
325BG. Profit and loss attribution requirement.
325BH. Requirements on risk measurement.
325BI. Qualitative requirements.
325BJ. Internal validation.
325BK. Calculation of stress scenario risk measure.

Internal default risk model

325BL. Scope of the internal default risk model.
325BM. Approval to use an internal default risk model.
325BN. Own funds requirements for default risk using an internal default risk model.
325BO. Recognition of hedges in an internal default risk model.
325BP. Particular requirements for an internal default risk model.

CHAPTER 2
OWN FUNDS REQUIREMENTS FOR POSITION RISK

General provisions and specific instruments

326. Own funds requirements for position risk.
327. Netting.
328. Interest rate futures and forwards.
329. Options and warrants.
330. Swaps.
331. Interest rate risk on derivative instruments.
332. Credit derivatives.
333. Securities sold under a repurchase agreement or lent.

Debt instruments

334. Net positions in debt instruments.
335. Cap on the own funds requirement for a net position
336. Own funds requirement for non-securitisation debt instruments.
337. Own funds requirement for securitisation instruments.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

338. Own funds requirement for the correlation trading portfolio.
339. Maturity-based calculation of general risk.
340. Duration-based calculation of general risk.

Equities

341. Net positions in equity instruments.
342. Specific risk of equity instruments.
343. General risk of equity instruments.
344. Stock indices.

Underwriting

345. Reduction of net positions.

Specific risk own funds requirements for positions hedged by credit derivatives

346. Allowance for hedges by credit derivatives.
347. Allowance for hedges by first and nth-to default credit derivatives.

Own funds requirements for CIUs

348. Own funds requirements for CIUs.
349. General criteria for CIUs.
350. Specific methods for CIUs.

CHAPTER 3
OWN FUNDS REQUIREMENTS FOR FOREIGN-EXCHANGE RISK

351. De minimis and weighting for foreign exchange risk.
352. Calculation of the overall net foreign exchange position.
353. Foreign exchange risk of CIUs
354. Closely correlated currencies.

CHAPTER 4
OWN FUNDS REQUIREMENTS FOR COMMODITIES RISK

355. Choice of method for commodities risk.
356. Ancillary commodities business.
357. Positions in commodities.
358. Particular instruments.
359. Maturity ladder approach.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

360. Simplified approach.
361. Extended maturity ladder approach.

CHAPTER 5
USE OF INTERNAL MODELS TO CALCULATE OWN FUNDS REQUIREMENTS

Approval and own funds requirements

362. Specific and general risks.
363. Approval to use internal models.
364. Own funds requirements when using internal models.

General requirements

365. VaR and stressed VaR Calculation.
366. Regulatory back testing and multiplication factors.
367. Requirements on risk measurement.
368. Qualitative requirements.
369. Internal Validation.

Requirements particular to specific risk modelling

370. Requirements for modelling specific risk.
371. Exclusions from specific risk models.

Internal Model for incremental default and migration risk

372. Requirement to have an internal IRC model.
373. Scope of the internal IRC model.
374. Parameters of the internal IRC model.
375. Recognition of hedges in the internal IRC model.
376. Particular requirements for the internal IRC model.

Internal model for correlation trading

377. Requirements for an internal model for correlation trading.

TITLE 5
OWN FUNDS REQUIREMENTS FOR SETTLEMENT RISK

378. Settlement/delivery risk.
379. Free deliveries.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

380. Waiver.

TITLE 6
OWN FUNDS REQUIREMENTS FOR CREDIT VALUATION ADJUSTMENT RISK

381. Meaning of credit valuation adjustment.
382. Scope.
383. Advanced method.
384. Standardised method.
385. Alternative to using CVA methods to calculating own funds requirements.
386. Eligible hedges.

PART 4
LARGE EXPOSURES

387. Subject matter.
388. [Not used]
389. Definition.
390. Calculation of the exposure value.
391. Definition of an institution for large exposures purposes.
392. Definition of a large exposure.
393. Capacity to identify and manage large exposures.
394. Reporting requirements.
395. Limits to large exposures.
396. Compliance with large exposures requirements.
397. Calculating additional own funds requirements for large exposures in the trading book.
398. Procedures to prevent institutions from avoiding the additional own funds requirement.
399. Eligible credit mitigation techniques.
400. Exemptions.
401. Calculating the effect of the use of credit risk mitigation techniques.
402. Exposures arising from mortgage lending.
403. Substitution approach.

PART 5
EXPOSURES TO TRANSFERRED CREDIT RISK

TITLE 1
GENERAL PROVISIONS FOR THIS PART

404. [Not used]

TITLE 2

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

REQUIREMENTS FOR INVESTOR INSTITUTIONS

405. to 407. [Not used]

TITLE 3
REQUIREMENTS FOR SPONSOR AND ORIGINATOR INSTITUTIONS

408. to 410. [Not used]

PART 6
DEFINITIONS AND LIQUIDITY REQUIREMENTS

TITLE 1
DEFINITIONS AND LIQUIDITY COVERAGE REQUIREMENT

411. Definitions.
412. Liquidity coverage requirement.
413. Stable funding requirement.
414. Compliance with liquidity requirements.

TITLE 2
LIQUIDITY REPORTING

415. Reporting obligation and reporting format.
416. Reporting on liquid assets.
417. Operational requirements for holdings of liquid assets.
418. Valuation of liquid assets.
419. Currencies with constraints on the availability of liquid assets.
420. Liquidity outflows.
421. Outflows on retail deposits.
422. Outflows on other liabilities.
423. Additional outflows.
424. Outflows from credit and liquidity facilities.
425. Inflows.
426. [Not used]

TITLE 3
REPORTING ON STABLE FUNDING

427. Items providing stable funding.
428. Items requiring stable funding.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

TITLE 4
THE NET STABLE FUNDING RATIO

CHAPTER 1
THE NET STABLE FUNDING RATIO

428A. Application on a consolidated basis.
428B. The net stable funding ratio.

CHAPTER 2
GENERAL RULES FOR THE CALCULATION OF THE NET STABLE FUNDING RATIO

428C. Calculation of the net stable funding ratio.
428D. Derivative contracts.
428DA. Derivative Client Clearing.
428E. Netting of secured lending transactions and capital market-driven transactions.
428F. Interdependent assets and liabilities.
428G. [Not used]
428H. Preferential treatment within a group.

CHAPTER 3
AVAILABLE STABLE FUNDING

General provisions

428I. Calculation of the amount of available stable funding.
428J. Residual maturity of a liability or of own funds.

Available stable funding factors

428K. 0% available stable funding factor.
428L. 50% available stable funding factor.
428M. 90% available stable funding factor.
428N. 95% available stable funding factor.
428O. 100% available stable funding factor.

CHAPTER 4
REQUIRED STABLE FUNDING

General provisions

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

428P. Calculation of the amount of required stable funding.
428Q. Residual maturity of an asset.

Required stable funding factors

428R. 0% required stable funding factor.
428RA. 2.5% required stable funding factor.
428S. 5% required stable funding factor.
428T. 7% required stable funding factor.
428U. [Not used]
428V. 10% required stable funding factor.
428W. 12% required stable funding factor.
428X. 15% required stable funding factor.
428Y. 20% required stable funding factor.
428Z. 25% required stable funding factor.
428AA. 30% required stable funding factor.
428AB. 35% required stable funding factor.
428AC. 40% required stable funding factor.
428AD. 50% required stable funding factor.
428AE. 55% required stable funding factor.
428AF. 65% required stable funding factor.
428AG. 85% required stable funding factor.
428AH. 100% required stable funding factor.

CHAPTER 5
DEROGATION FOR SMALL AND NON-COMPLEX INSTITUTIONS

428AI. Derogation for small and non-complex institutions.

CHAPTER 6
AVAILABLE STABLE FUNDING FOR THE SIMPLIFIED CALCULATION OF THE NET STABLE FUNDING RATIO

General provisions

428AJ. Simplified calculation of the amount of available stable funding.
428AK. Residual maturity of a liability or own funds.

Available stable funding factors

428AL. 0% available stable funding factor.
428AM. 50% available stable funding factor.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

428AN. 90% available stable funding factor.
428AO. 95% available stable funding factor.
428AP. 100% available stable funding factor.

CHAPTER 7
REQUIRED STABLE FUNDING FOR THE SIMPLIFIED CALCULATION OF THE NET STABLE FUNDING RATIO

General provisions

428AQ. Simplified calculation of the amount of required stable funding.
428AR. Residual maturity of an asset.

Required stable funding factors

428AS. 0% required stable funding factor.
428AT. 5% required stable funding factor.
428AU. 10% required stable funding factor.
428AV. 20% required stable funding factor.
428AW. 50% required stable funding factor.
428AX. 55% required stable funding factor.
428AXA. 65% required stable funding factor.
428AY. 85% required stable funding factor.
428AZ. 100% required stable funding factor.

PART 7
LEVERAGE

429. Calculation of the leverage ratio.
429A. Exposures excluded from the total exposure measure.
429B. Calculation of the exposure value of assets.
429C. Calculation of the exposure value of derivatives.
429D. Additional provisions on the calculation of the exposure value of written credit derivatives.
429E. Counterparty credit risk add-on for securities financing transactions.
429F. Calculation of the exposure value of off-balance-sheet items.
429G. Calculation of the exposure value of regular-way purchases and sales awaiting settlement.

PART 7A
REPORTING REQUIREMENTS

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

430. Reporting on prudential requirements and financial information.
430A. Specific reporting obligations.
430B. Specific reporting requirements for market risk.

PART 8
DISCLOSURE BY INSTITUTIONS

TITLE 1
GENERAL PRINCIPLES

431. Disclosure requirements and policies.
432. Non-material, proprietary or confidential information.
433. Frequency and scope of disclosure.
433A. Disclosures by large institutions.
433B. Disclosures by small and non-complex institutions.
433C. Disclosures by other institutions.
434. Means of disclosures.
434A. [Not used]

TITLE 2
TECHNICAL CRITERIA ON TRANSPARENCE AND DISCLOSURE

435. Disclosure of risk management objectives and policies.
436. Disclosure of the Scope of application.
437. Disclosure of the Own funds.
437A. Disclosure of own funds and eligible liabilities.
438. Disclosure of own funds requirements and risk-weighted exposure amounts.
439. Disclosure of exposures to counterparty credit risk.
440. Disclosure of countercyclical capital buffers.
441. Disclosure of indicators of global systemic importance.
442. Disclosure of exposures to credit risk and dilution risk.
443. Disclosure of encumbered and unencumbered assets.
444. Disclosure of the use of the Standardised Approach.
445. Disclosure of exposure to market risk.
446. Disclosure of operational risk management.
447. Disclosure of key metrics.
448. Disclosure of exposures to interest rate risk on positions not held in the trading book.
449. Disclosure of exposures to securitisation positions.
449A. Disclosure of environmental, social and governance risks (ESG risks).
450. Disclosure of remuneration policy.
451. Disclosure of the leverage ratio.
451A. Disclosure of liquidity requirements.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

TITLE 3
QUALIFYING REQUIREMENTS FOR THE USE OF PARTICULAR INSTRUMENTS OR METHODOLOGIES

452. Disclosure of the use of the IRB Approach to credit risk.
453. Disclosure of the use of credit risk mitigation techniques.
454. Disclosure of the use of the Advanced Measurement Approaches to operational risk.
455. Use of Internal Market Risk Models.

PART 9
REGULATIONS AND PRUDENTIAL MEASURES

456. Regulations.
457. [Not used]
458. Enhanced prudential requirements.
459. [Not used]
460. Liquidity.
461. [Not used]
461A. [Not used]
462. to 464. [Not used]

PART 10
TRANSITIONAL PROVISIONS, REPORTS, REVIEWS AND AMENDMENTS

TITLE 1
TRANSITIONAL PROVISIONS

CHAPTER 1
OWN FUNDS REQUIREMENTS, UNREALISED GAINS AND LOSSES MEASURED AT FAIR VALUE AND DEDUCTIONS

Own funds requirements

465. [Not used]
466. First time application of International Financial Reporting Standards.

Unrealised gains and losses measured at fair value

467. to 468. [Not used]

Deductions

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

469. [Not used]
469A. [Not used]
470. to 473. [Not used]
473A. [Not used]
474. to 480. [Not used]

Additional filters and deductions

481. [Not used]
482. Scope of application for derivatives transactions with pension funds.

Instruments not constituting State aid

483. to 491. [Not used]

CHAPTER 3
TRANSITIONAL PROVISIONS FOR DISCLOSURE OF OWN FUNDS

492. [Not used]

CHAPTER 4
LARGE EXPOSURES, OWN FUNDS REQUIREMENTS, LEVERAGE AND BASEL I FLOOR

493. to 494. [Not used]
494A. to 494B. [Not used]
495. to 498. [Not used]
499. Leverage
500. [Not used]
500A. to 500D. [Not used]
501. Adjustment of risk-weighted non-defaulted SME exposures.
501A. [Not used]
502. to 520. [Not used]

PART 11
FINAL PROVISIONS

521. Entry into force and date of application.
522. Saving for pre-exit decisions.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

SCHEDULE 1
CLASSIFICATION OF OFF-BALANCE SHEET ITEMS

SCHEDULE 2
TYPES OF DERIVATIVES

SCHEDULE 3
ITEMS SUBJECT TO SUPPLEMENTARY REPORTING OF LIQUID ASSETS

SCHEDULE 4
SUPPLEMENTARY REQUIREMENTS

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

PART 1
GENERAL PROVISIONS

TITLE 1
SUBJECT MATTER, SCOPE AND DEFINITIONS

CHAPTER 1
GENERAL PROVISIONS

Scope.

1.(1) These Standards set uniform obligations concerning general prudential requirements that institutions, financial holding companies set up in Gibraltar, and mixed financial holding companies set up in Gibraltar must comply with in relation to the following items–

(a) own funds requirements relating to entirely quantifiable, uniform and standardised elements of credit risk, market risk, operational risk, settlement risk and leverage;

(b) requirements limiting large exposures;

(c) liquidity requirements relating to entirely quantifiable, uniform and standardised elements of liquidity risk;

(d) reporting requirements related to sub-paragraphs (a), (b) and (c);

(e) public disclosure requirements.

(2) These Standards also set uniform obligations concerning the own funds and eligible liabilities requirements that resolution entities that are global systemically important institutions (G-SIIs) or part of G-SIIs and material subsidiaries of third-country G-SIIs must comply with.

(3) Schedule 4 contains supplementary technical standards which impose detailed requirements for the application of specific Articles of these Standards.

Supervisory powers.

2.(1) For the purpose of ensuring compliance with these Standards, the GFSC has the powers and must follow the procedures set out in the Act, the CICR Regulations and these Standards.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(2) For the purpose of ensuring compliance with these Standards, the Gibraltar Resolution Authority has the powers and must follow the procedures set out in the Act, the Recovery and Resolution Regulations and these Standards.

(3) The GFSC and the Gibraltar Resolution Authority may cooperate for the purpose of ensuring compliance with the requirements concerning own funds and eligible liabilities.

(4) The GFSC must treat investment firms to which regulation 4(3) and (4) or 4(7) of the IFPR Regulations apply as if they were institutions under these Standards.

Application of stricter requirements by institutions.

3. Nothing in these Standards prevents institutions from holding own funds and their components in excess of, or applying measures that are stricter than, those required by these Standards.

Definitions.

4.(1) In these Standards–

"accumulated other comprehensive income" has the same meaning as under International Accounting Standard (IAS) 1, as applicable under UK-adopted international accounting standards;

"the Act" means the Financial Services Act 2019;

"additional Tier 1 own-fund insurance items" means basic own-fund items of insurance and reinsurance undertakings where those items are classified in Tier 1 in accordance with regulation 86(1) of the Financial Services (Insurance Companies) Regulations 2020 and the inclusion of those items is limited by Article 82(3) of the Financial Services (Solvency 2) (Technical Standards) Regulations 2025;

"ancillary services undertaking" means an undertaking the principal activity of which consists of owning or managing property, managing data-processing services, or a similar activity which is ancillary to the principal activity of one or more institutions;

"applicable accounting framework" means the accounting standards to which the institution is subject under UK-adopted international accounting standards or the Financial Services (Credit Institutions) (Accounts) Regulations 2021;

"asset management company" means a person who has Part 7 permission to carry on the regulated activity of–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) managing a UCITS (as specified in paragraph 93 of Schedule 2 to the Act), or would require that permission if its registered office were located in Gibraltar;

(b) managing an AIF (as specified in paragraph 95 of Schedule 2 to the Act), or would require that permission if its registered office were located in Gibraltar; or

(c) managing a small AIF (as specified in paragraph 97 of Schedule 2 to the Act), or would require that permission if its registered office were located in Gibraltar; including, unless otherwise provided, a third-country entity that carries out similar activities and is subject to the laws of a third country which applies supervisory and regulatory requirements at least equivalent to those applied in Gibraltar;

"authorisation" means an instrument issued in any form by the authorities by which the right to carry out the business is granted;

"bail-in tool" means the mechanism for effecting the exercise by the resolution authority of the write-down and conversion powers in relation to liabilities of an institution under resolution, in accordance with regulation 43 of the Recovery and Resolution Regulations;

"basic own funds" means basic own funds within the meaning of regulation 82 of the Financial Services (Insurance Companies) Regulations 2020;

"branch" means a place of business which forms a legally dependent part of an institution and which carries out directly all or some of the transactions inherent in the business of institutions;

"cash assimilated instrument" means a certificate of deposit, bond (including a covered bond) or any other non-subordinated instrument, which has been issued by an institution or an investment firm, for which the institution or investment firm has already received full payment and which is to be unconditionally reimbursed by the institution or investment firm at its nominal value;

"central banks" means the Ministry of Finance, the European Central Bank and the central banks of third countries;

"central counterparty" or "CCP" means a CCP as defined in Article 2(1) of EMIR;

"CICR Regulations" means the Financial Services (Credit Institutions and Capital Requirements) Regulations 2020;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

“close links” means a situation in which two or more natural or legal persons are linked in any of the following ways–

(a) participation in the form of ownership, direct or by way of control, of 20% or more of the voting rights or capital of an undertaking;

(b) control;

(c) a permanent link of both or all of them to the same third person by a control relationship;

“collective investment undertaking” or “CIU” means a UCITS within the meaning of Part 18 of the Act or an alternative investment fund (AIF) within the meaning of the Act;

“commodity and emission allowance dealer” means an undertaking the main business of which consists exclusively of the provision of investment services or activities in relation to–

(a) commodity derivatives or commodity derivative contracts in paragraph 46(5), (6), (7), (9) and (10) of Schedule 2 to the Act;

(b) derivatives of emission allowances in paragraph 46(4) of that Schedule; or

(c) emission allowances in paragraph 46(11) of that Schedule;

“commodity risk” means the risk of losses arising from movements in commodity prices;

“common management relationship” means a relationship between an undertaking (“U1”) and one or more other undertakings (“U2”) which satisfies the following conditions–

(a) U1 and U2 are not connected in the manner described in section 276 of the Companies Act 2014; and

(b) either–

(i) U1 and U2 are managed on a unified basis pursuant to a contract with U1, or provisions in U2's memorandum or articles of association; or

(ii) the administrative, management or supervisory bodies of U2 consist, for the major part, of the same persons in office as U1, during the financial year of U1 for which it is being decided whether such a relationship exists;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

"competent authority" means–

(a) in Gibraltar, the GFSC; or

(b) in a third country, the body which is recognised and empowered by law to supervise institutions as part of the supervisory system in operation in that country;

"consolidated basis" means on the basis of the consolidated situation;

"consolidated situation" means the situation that results from applying the requirements of these Standards in accordance with Part 1, Title 2, Chapter 2 to an institution as if that institution formed, together with one or more other entities, a single institution;

"consolidating supervisor" means the GFSC when exercising supervision on a consolidated basis, in accordance with the CICR Regulations, of–

(a) a Gibraltar parent institution; or

(b) an institution controlled by a Gibraltar parent financial holding company or Gibraltar parent mixed financial holding company;

"control" means the relationship between a parent undertaking and a subsidiary, as defined in section 276 of the Companies Act 2014, or a similar relationship between any natural or legal person and an undertaking;

"conversion factor" means the ratio of the currently undrawn amount of a commitment that could be drawn and that would therefore be outstanding at default to the currently undrawn amount of the commitment, the extent of the commitment being determined by the advised limit, unless the unadvised limit is higher;

"CRA Regulation" means Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies;

"credit enhancement" means a contractual arrangement whereby the credit quality of a position in a securitisation is improved in relation to what it would have been if the enhancement had not been provided, including the enhancement provided by more junior tranches in the securitisation and other types of credit protection;

"credit institution" means an undertaking the business of which consists of any of the following–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) to take deposits or other repayable funds from the public and to grant credits for its own account;

(b) to carry out any of the activities in paragraphs 50 and 53 of Schedule 2 to the Act, where one of the following applies, but the undertaking is not a commodity and emission allowance dealer, a collective investment undertaking or an insurance undertaking–

(i) the total value of the consolidated assets of the undertaking is €30 billion or more;

(ii) the total value of the assets of the undertaking is less than €30 billion, and the undertaking is part of a group in which the total value of the consolidated assets of all undertakings in that group that individually have total assets of less than €30 billion and that carry out any of the activities in paragraphs 50 and 53 of Schedule 2 to the Act is €30 billion or more; or

(iii) the total value of the assets of the undertaking is less than €30 billion, and the undertaking is part of a group in which the total value of the consolidated assets of all undertakings in the group that carry out any of the activities in paragraphs 50 and 53 of Schedule 2 to the Act is €30 billion or more, where the GFSC so decides in order to address potential risks of circumvention and potential risks for the financial stability of Gibraltar.

and, for the purposes of sub-paragraphs (b)(ii) and (b)(iii), where the undertaking is part of a third-country group, the total assets of each branch of the third-country group authorised Gibraltar must be included in the combined total value of the assets of all undertakings in the group;

“credit risk adjustment” means the amount of specific and general loan loss provision for credit risks that has been recognised in the financial statements of the institution in accordance with the applicable accounting framework;

“credit risk mitigation” means a technique used by an institution to reduce the credit risk associated with an exposure or exposures which that institution continues to hold;

“CRR covered bonds” means bonds issued by a credit institution which–

(a) has its registered office in Gibraltar; and

(b) is subject by law to special public supervision designed to protect bondholders and, in particular, protection under which–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(i) sums deriving from the issue of the bond must be invested in conformity with the law in assets;

(ii) during the whole period of validity of the bond, those sums are capable of covering claims attaching to the bond; and

(iii) in the event of failure of the issuer, those sums would be used on a priority basis for the reimbursement of the principal and payment of the accrued interest;

"default fund" means a fund established by a CCP in accordance with Article 42 of EMIR and used in accordance with Article 45 of that Regulation;

"defined benefit pension fund assets" means the assets of a defined pension fund or plan, as applicable, calculated after they have been reduced by the amount of obligations under the same fund or plan;

"deferred tax assets" has the same meaning as under the applicable accounting framework;

"deferred tax assets that rely on future profitability" means deferred tax assets the future value of which may be realised only in the event the institution generates taxable profit in the future;

"deferred tax liabilities" has the same meaning as under the applicable accounting framework;

"dilution risk" means the risk that an amount receivable is reduced through cash or non-cash credits to the obligor;

"discretionary pension benefits" means enhanced pension benefits granted on a discretionary basis by an institution to an employee as part of that employee's variable remuneration package, which do not include accrued benefits granted to an employee under the terms of the company pension scheme;

"distributable items" means the amount of the profits at the end of the last financial year plus any profits brought forward and reserves available for that purpose, before distributions to holders of own funds instruments, less any losses brought forward, any profits which are non-distributable under the law of Gibraltar or a third country or the institution's by-laws and any sums placed in non-distributable reserves in accordance with national law or the statutes of the institution, in each case with respect to the specific category of own funds instruments to which the law of Gibraltar

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

or a third country or the institution’s' by-laws or statutes relate; such profits, losses and reserves being determined on the basis of the individual accounts of the institution and not on the basis of the consolidated accounts;

“distributions” means the payment of dividends or interest in any form;

“eligible capital” means the following–

(a) for the purposes of Title 3 of Part 2 it means the sum of the following–

(i) Tier 1 capital as referred to in Article 25, without applying the deduction in Article 36(1)(k)(i);

(ii) Tier 2 capital as referred to in Article 71 that is equal to or less than one third of Tier 1 capital as calculated pursuant to paragraph (i);

(b) for the purposes of Article 97 it means the sum of the following–

(i) Tier 1 capital as referred to in Article 25;

(ii) Tier 2 capital as referred to in Article 71 that is equal to or less than one third of Tier 1 capital;

“EMIR” means Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories;

“external credit assessment institution” or “ECAI” means a credit rating agency that is registered or certified in accordance with the CRA Regulation or a central bank issuing credit ratings which are exempt from the application of that Regulation;

“financial holding company” means a financial institution, the subsidiaries of which are exclusively or mainly institutions or financial institutions, and which is not a mixed financial holding company; the subsidiaries of a financial institution are mainly institutions or financial institutions where at least one of them is an institution and where more than 50% of the financial institution's equity, consolidated assets, revenues, personnel or other indicator considered relevant by the competent authority are associated with subsidiaries that are institutions or financial institutions;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

"financial institution" means an undertaking other than an institution or a pure industrial holding company, the principal activity of which is to acquire holdings or to pursue one or more of the activities listed in paragraphs 2 to 12 and 15 of Schedule 1 to the CICR Regulations, including an investment firm, a financial holding company, a mixed financial holding company, an investment holding company, a payment institution (within the meaning of regulation 2 of the Financial Services (Payment Services) Regulations 2020) or an asset management company, but excluding insurance holding companies and mixed-activity insurance holding companies within the meaning of regulation 191 of the Financial Services (Insurance Companies) Regulations 2020;

"financial instrument" means any of the following–

(a) a contract that gives rise to both a financial asset of one party and a financial liability or equity instrument of another party;

(b) an instrument specified in paragraph 46 of Schedule 2 to the Act;

(c) a derivative financial instrument;

(d) a primary financial instrument;

(e) a cash instrument;

but the instruments in sub-paragraphs (a), (b) and (c) are only financial instruments if their value is derived from the price of an underlying financial instrument or another underlying item, a rate, or an index;

"financial report" means, for the purposes of Part 8, a financial report within the meaning of sections 359 and 360 of the Act.

"financial sector entity" means any of the following–

(a) an institution;

(b) a financial institution;

(c) an ancillary services undertaking included in the consolidated financial situation of an institution;

(d) an insurance undertaking;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(e) a third-country insurance undertaking;

(f) a reinsurance undertaking;

(g) a third-country reinsurance undertaking;

(h) an insurance holding company within the meaning of regulation 191 of the Financial Services (Insurance Companies) Regulations 2020;

(i) an undertaking excluded from the scope of the Financial Services (Insurance Companies) Regulations 2020 in accordance with regulation 5 of those Regulations;

(j) a third-country undertaking with a main business comparable to any of the entities referred to in sub-paragraphs (a) to (k);

“foreign exchange risk” means the risk of losses arising from movements in foreign exchange rates;

“funded credit protection” means a technique of credit risk mitigation where the reduction of the credit risk on the exposure of an institution derives from the right of that institution, in the event of the default of the counterparty or on the occurrence of other specified credit events relating to the counterparty, to liquidate, or to obtain transfer or appropriation of, or to retain certain assets or amounts, or to reduce the amount of the exposure to, or to replace it with, the amount of the difference between the amount of the exposure and the amount of a claim on the institution;

“funds for general banking risk” means those amounts which a credit institution decides to put aside to cover the particular risks associated with banking where this is permitted under the applicable accounting framework;

“GFSC” means the Gibraltar Financial Services Commission within the meaning of section 21(1) of the Act;

“Gibraltar parent credit institution” means a Gibraltar parent institution that is a credit institution;

“Gibraltar parent financial holding company” means a financial holding company which is not a subsidiary of an institution authorised in Gibraltar or of a financial holding company or mixed financial holding company set up in Gibraltar;

“Gibraltar parent institution” means an institution in Gibraltar–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) which–

(i) has an institution, a financial institution or an ancillary services undertaking as a subsidiary; or

(ii) holds a participation in an institution, financial institution or ancillary services undertaking; and

(b) which is not a subsidiary of–

(i) another institution authorised in Gibraltar; or

(ii) a financial holding company or mixed financial holding company set up in Gibraltar;

“Gibraltar parent investment firm” means a Gibraltar parent undertaking that is an investment firm;

“Gibraltar parent mixed financial holding company” means a mixed financial holding company which is not a subsidiary of an institution authorised in Gibraltar, or of a financial holding company or mixed financial holding company set up in Gibraltar;

“Gibraltar Resolution Authority” means the Gibraltar Resolution Authority within the meaning of section 284 of the Act;

“global systemically important institution” or “G-SII” means a G-SII that has been identified in accordance with regulation 85(1) to (7) of the CICR Regulations;

“goodwill” has the same meaning as under the applicable accounting framework;

“group” means a group of undertakings of which at least one is an institution and which consists of a parent undertaking and its subsidiaries, or of undertakings that are related to each other by a common management relationship;

“group of connected clients” means any of the following–

(a) two or more natural or legal persons who, unless it is shown otherwise, constitute a single risk because one of them, directly or indirectly, has control over the other or others;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(b) two or more natural or legal persons between whom there is no relationship of control as described in sub-paragraph (a) but who are to be regarded as constituting a single risk because they are so interconnected that, if one of them were to experience financial problems, in particular funding or repayment difficulties, the other or all of the others would also be likely to encounter funding or repayment difficulties,

but two or more natural or legal persons who fulfil the conditions set out in sub-paragraphs (a) or (b) because of their direct exposure to the same CCP for clearing activities purposes are not considered as constituting a group of connected clients.

Despite sub-paragraphs (a) and (b), where a central government has direct control over or is directly interconnected with more than one natural or legal person, the set consisting of the central government and all of the natural or legal persons directly or indirectly controlled by it in accordance with sub-paragraph (a), or interconnected with it in accordance with sub-paragraph (b), may be considered as not constituting a group of connected clients. Instead the existence of a group of connected clients formed by the central government and other natural or legal persons may be assessed separately for each of the persons directly controlled by it in accordance with sub-paragraph (a), or directly interconnected with it in accordance with sub-paragraph (b), and all of the natural and legal persons which are controlled by that person according to sub-paragraph (a) or interconnected with that person in accordance with sub-paragraph (b), including the central government. The same applies in cases of regional governments or local authorities to which Article 115(2) applies.

"G-SII entity" means an entity with legal personality that is a G-SII or is part of a G-SII or of a third-country G-SII;

"IFPR Regulations" means the Financial Services (Investment Firms (Prudential Requirements) Regulations 2021;

"independent price verification" means a process by which market prices or marking to model inputs are regularly verified for accuracy and independence;

"indirect holding" means any exposure to an intermediate entity that has an exposure to capital instruments issued by a financial sector entity where, in the event the capital instruments issued by the financial sector entity were permanently written off, the loss that the institution would incur as a result would not be materially different from the loss the institution would incur from a direct holding of those capital instruments issued by the financial sector entity;

"initial capital" means the amounts and types of own funds specified in regulation 11(1) of the CICR Regulations;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

"initial margin" or "IM" means any collateral, other than variation margin, collected from or posted to an entity to cover the current and potential future exposure of a transaction or of a portfolio of transactions in the period needed to liquidate those transactions, or to re-hedge their market risk, following the default of the counterparty to the transaction or portfolio of transactions;

"institution" means a credit institution with Part 7 permission given in accordance with regulation 8 of the CICR Regulations or an undertaking to which regulation 16C(4) of the CICR Regulations applies, and includes an investment firm to which Article 2(4) applies;

"insurance undertaking" has the meaning given in regulation 3(1) of the Financial Services (Insurance Companies) Regulations 2020;

"intangible assets" has the same meaning as under the applicable accounting framework and includes goodwill;

"internal hedge" means a position that materially offsets the component risk elements between a trading book position and one or more non-trading book positions or between two trading desks;

"investment firm" means an investment firm within the meaning of the Act, but does not include a credit institution;

"large institution" means an institution that meets any of the following conditions–

(a) it is a G-SII;

(b) it has been identified as another systemically important institution (O-SII) in accordance with regulation 85 of the CICR Regulations;

(c) the total value of its assets on an individual basis or, where applicable, on the basis of its consolidated situation in accordance with these Standards and the CICR Regulations is equal to or greater than €30 billion;

"large subsidiary" means a subsidiary that qualifies as a large institution;

"leverage" means the relative size of an institution's assets, off-balance sheet obligations and contingent obligations to pay or to deliver or to provide collateral, including obligations from received funding, made commitments, derivatives or repurchase

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

agreements, but excluding obligations which can only be enforced during the liquidation of an institution, compared to that institution's own funds;

“loss given default” or “LGD” means the ratio of the loss on an exposure due to the default of a counterparty to the amount outstanding at default;

“management body” means an institution's body, which is appointed in accordance with national law, which is empowered to set the institution's strategy, objectives and overall direction, and which oversees and monitors management decision-making, and includes the persons who effectively direct the business of the institution;

“management body in its supervisory function” means the management body acting in its role of overseeing and monitoring management decision-making;

“market risk” means the risk of losses arising from movements in market prices, including in foreign exchange rates or commodity prices;

“market value” means, for the purposes of immovable property, the estimated amount for which the property should exchange on the date of valuation between a willing buyer and a willing seller in an arm's-length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion;

“marking to market” means the valuation of positions at readily available close out prices that are sourced independently, including exchange prices, screen prices or quotes from several independent reputable brokers;

“marking to model” means any valuation which has to be benchmarked, extrapolated or otherwise calculated from one or more market inputs;

“material subsidiary” means a subsidiary that on an individual or consolidated basis meets any of the following conditions–

(a) the subsidiary holds more than 5% of the consolidated risk-weighted assets of its original parent undertaking;

(b) the subsidiary generates more than 5% of the total operating income of its original parent undertaking;

(c) the total exposure measure, referred to in Article 429(4) of these Standards, of the subsidiary is more than 5% of the consolidated total exposure measure of its original parent undertaking;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

"MiFIR" means Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012;

"the Minister" means the Minister with responsibility for financial services;

"minority interest" means the amount of Common Equity Tier 1 capital of a subsidiary of an institution that is attributable to natural or legal persons other than those included in the prudential scope of consolidation of the institution;

"mixed activity holding company" means a parent undertaking, other than a financial holding company or an institution or a mixed financial holding company, the subsidiaries of which include at least one institution;

"mixed financial holding company" means a parent undertaking which–

(a) is not a regulated entity;

(b) has at least one subsidiary which is a regulated entity and has its head office in Gibraltar; and

(c) together with its subsidiaries and other entities, constitutes a financial conglomerate;

"model risk" means the potential loss an institution may incur as a consequence of decisions that could be principally based on the output of internal models due to errors in the development, implementation or use of such models;

"mortgage lending value" means the value of immovable property as determined by a prudent assessment of the future marketability of the property taking into account long-term sustainable aspects of the property, the normal and local market conditions, the current use and alternative appropriate uses of the property;

"multilateral trading facility" has the meaning given in Article 2.1(14) of MiFIR;

"nominated ECAI" means an ECAI nominated by an institution;

"non-listed institution" means an institution that has not issued securities that are admitted to trading on a regulated market;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

"officially supported export credits" means loans or credits to finance the export of goods and services for which an official export credit agency provides guarantees, insurance or direct financing;

"one business year" when used in a formula, means one year expressed in business days using the relevant business day convention;

"one-year default rate" means the ratio between the number of defaults occurred during a period that starts from one year prior to a date T and the number of obligors assigned to this grade or pool one year prior to that date;

"operational risk" means the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, and includes legal risk;

"original lender" has the meaning given in Article 2(20) of the Securitisation Regulation;

"originator" has the meaning given in Article 2(3) of the Securitisation Regulation;

"other capital instruments" means capital instruments issued by financial sector entities that do not qualify as Common Equity Tier 1, Additional Tier 1 or Tier 2 instruments or Tier 1 own-fund insurance items, additional Tier 1 own-fund insurance items, Tier 2 own-fund insurance items or Tier 3 own-fund insurance items;

"other reserves" means reserves within the meaning of the applicable accounting framework that are required to be disclosed under the applicable accounting standard, excluding any amounts already included in accumulated other comprehensive income or retained earnings;

"own funds" means the sum of Tier 1 capital and Tier 2 capital;

"own funds instruments" means capital instruments issued by the institution that qualify as Common Equity Tier 1, Additional Tier 1 or Tier 2 instruments;

"parent undertaking" means–

(a) a parent undertaking within the meaning of section 276 of the Companies Act 2014; or

(b) for the purposes of Part 5 of these Standards–

(i) a parent undertaking within the meaning of section 276 of the Companies Act 2014, apart from the meaning given in section 276(4); or

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(ii) an undertaking which effectively exercises a dominant influence over another undertaking,

where section 276(5) of the Companies Act 2014 applies to parent undertakings falling within sub-paragraphs (b)(ii) as it applies to parent undertakings falling within section 276;

"Part 7 permission" means permission under Part 7 of the Act;

"participation" means rights in the capital of other undertakings, whether or not represented by certificates, which, by creating a durable link with those undertakings, are intended to contribute to the activities of the undertaking which holds those rights, or the ownership, direct or indirect, of 20% or more of the voting rights or capital of an undertaking;

"positions held with trading intent" means any of the following–

(a) proprietary positions and positions arising from client servicing and market making;

(b) positions intended to be resold short term;

(c) positions intended to benefit from actual or expected short-term price differences between buying and selling prices or from other price or interest rate variations;

"pre-funded contribution to the default fund of a CCP" means a contribution to the default fund of a CCP that is paid in by an institution;

"principal Standards" means the provisions in Articles 1 to 522 and Schedules 1 to 3;

"probability of default" or "PD" means the probability of default of a counterparty over a one-year period;

"profit" has the same meaning as under the applicable accounting framework;

"public sector entity" means a non-commercial administrative body responsible to central governments, regional governments or local authorities, or to authorities that exercise the same responsibilities as regional governments and local authorities, or a non-commercial undertaking that is owned by or set up and sponsored by central governments, regional governments or local authorities, and that has explicit

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

guarantee arrangements, and may include self-administered bodies governed by law that are under public supervision;

"qualifying central counterparty" or "QCCP" means a central counterparty that has been either authorised in accordance with Article 14 of EMIR or recognised in accordance with Article 25 of that Regulation;

"qualifying holding" means a direct or indirect holding in an undertaking which represents 10% or more of the capital or of the voting rights or which makes it possible to exercise a significant influence over the management of that undertaking;

"reciprocal cross holding" means a holding by an institution of the own funds instruments or other capital instruments issued by financial sector entities where those entities also hold own funds instruments issued by the institution;

"recognised exchange" means an exchange which meets all of the following conditions–

(a) it is a regulated market or a third-country market that is considered to be equivalent to a regulated market in accordance with regulation 40 of the Financial Services (Investment Services) Regulations 2020;

(b) it has a clearing mechanism whereby contracts listed in Schedule 2 are subject to daily margin requirements which, in the opinion of the competent authorities, provide appropriate protection;

"Recovery and Resolution Regulations" means the Financial Services (Recovery and Resolution) Regulations 2020;

"reference obligation" means an obligation used for the purposes of determining the cash settlement value of a credit derivative;

"regulated market" has the meaning given in Article 2.1(13A) of MiFIR;

"reinsurance undertaking" has the meaning given in regulation 3(1) of the Financial Services (Insurance Companies) Regulations 2020;

"repurchase agreement" and "reverse repurchase agreement" mean any agreement in which an institution or its counterparty transfers securities or commodities or guaranteed rights relating to title to securities or commodities where that guarantee is issued by a recognised exchange which holds the rights to the securities or commodities and the agreement does not allow an institution to transfer or pledge a particular security or commodity to more than one counterparty at one time, subject to a commitment to

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

repurchase them, or substituted securities or commodities of the same description at a specified price on a future date specified, or to be specified, by the transferor, being a repurchase agreement for the institution selling the securities or commodities and a reverse repurchase agreement for the institution buying them;

"repurchase transaction" means any transaction governed by a repurchase agreement or a reverse repurchase agreement;

"resecuritisation" means a resecuritisation as defined in Article 2(4) of the Securitisation Regulation;

"re-securitisation position" means an exposure to a re-securitisation;

"residential property" means a residence which is occupied by the owner or the lessee of the residence;

"resolution authority" means the Gibraltar Resolution Authority (or, where the context requires, the resolution authority of a third country;

"resolution entity" means a resolution entity as defined in regulation 3 of the Recovery and Resolution Regulations;

"resolution group" means a resolution group as defined in regulation 3 of the Recovery and Resolution Regulations;

"retained earnings" means profits and losses brought forward as a result of the final application of profit or loss under the applicable accounting framework;

"risk of excessive leverage" means the risk resulting from an institution's vulnerability due to leverage or contingent leverage that may require unintended corrective measures to its business plan, including distressed selling of assets which might result in losses or in valuation adjustments to its remaining assets;

"securities financing transaction" means a repurchase transaction, a securities or commodities lending or borrowing transaction, or a margin lending transaction;

"securitisation" means a securitisation as defined in Article 2(1) of the Securitisation Regulation;

"securitisation position" means a securitisation position as defined in Article 2(19) of the Securitisation Regulation;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

"Securitisation Regulation" has the meaning given in the CICR Regulations;

"securitisation special purpose entity" or "SSPE" means a securitisation special purpose entity or SSPE as defined in Article 2(2) of the Securitisation Regulation;

"senior management" means those individuals who exercise executive functions within an institution and who are responsible, and accountable to the management body, for the day-to-day management of the institution;

"servicer" means an entity that manages a pool of purchased receivables or the underlying credit exposures on a day-to-day basis;

"share premium account" has the same meaning as under the applicable accounting framework;

"simple repurchase agreement" means a repurchase transaction of a single asset, or of similar, non-complex assets, as opposed to a basket of assets;

"small and non-complex institution" means an institution that meets all the following conditions–

(a) it is not a large institution;

(b) the total value of its assets on an individual basis or, where applicable, on a consolidated basis in accordance with these Standards and the CICR Regulations is on average equal to or less than the threshold of €5 billion over the four-year period immediately preceding the current annual reporting period;

(c) it is not subject to any obligations, or is subject to simplified obligations, in relation to recovery and resolution planning in accordance with regulation 4 of the Recovery and Resolution Regulations;

(d) its trading book business is classified as small within the meaning of Article 94(1);

(e) the total value of its derivative positions held with trading intent does not exceed 2% of its total on- and off-balance-sheet assets and the total value of its overall derivative positions does not exceed 5%, both calculated in accordance with Article 273A(3);

(f) more than 75% of both the institution's consolidated total assets and liabilities, excluding in both cases the intragroup exposures, relate to activities with counterparties located in Gibraltar;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(g) the institution does not use internal models to meet the prudential requirements in accordance with these Standards, except for subsidiaries using internal models developed at the group level, if the group is subject to the disclosure requirements laid down in Article 433A or 433C on a consolidated basis;

(h) the institution has not communicated to the GFSC an objection to being classified as a small and non-complex institution;

(i) the GFSC has not decided that the institution is not to be considered a small and non-complex institution on the basis of an analysis of its size, interconnectedness, complexity or risk profile;

"speculative immovable property financing" means loans for the purposes of the acquisition of or development or construction on land in relation to immovable property, or of and in relation to such property, with the intention of reselling for profit;

"sponsor" has the meaning given in Article 2(5) of the Securitisation Regulation;

"sub-consolidated basis" means on the basis of the consolidated situation of a parent institution, financial holding company or mixed financial holding company, excluding a sub-group of entities, or on the basis of the consolidated situation of a parent institution, financial holding company or mixed financial holding company that is not the ultimate parent institution, financial holding company or mixed financial holding company;

"subsidiary" means–

(a) a subsidiary undertaking within the meaning of section 276 of the Companies Act 2014; or

(b) for the purposes of Part 5 of these Standards –

(i) a subsidiary undertaking within the meaning of section 276 of the Companies Act 2014, apart from the meaning given in section 276(4); or

(ii) an undertaking over which another undertaking effectively exercises a dominant influence,

where section 276(5) of the Companies Act 2014 applies to subsidiaries falling within sub-paragraph (b)(ii) as it applies to subsidiaries falling within section 276;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

“synthetic holding” means an investment by an institution in a financial instrument the value of which is directly linked to the value of the capital instruments issued by a financial sector entity;

“systemic risk” means a risk of disruption in the financial system of Gibraltar with the potential to have serious negative consequences for the financial system and the real economy of Gibraltar;

“technical standards” means technical standards set out in regulations made by the Minister under section 626A of the Act;

“temporary differences” has the same meaning as under the applicable accounting framework;

“third country” means a country or territory outside Gibraltar.

“third-country insurance undertaking” has the meaning given in regulation 3(1) of the Financial Services (Insurance Companies) Regulations 2020;

“third-country investment firm” means a firm which–

(a) would be an investment firm if it were established in Gibraltar;

(b) is authorised in a third country; and

(c) is subject to and complies with prudential rules which the GFSC considers to be at least as stringent as those under these Standards or the CICR Regulations;

“third-country global systemically important institution” or “third-country G-SII” means a global systemically important banking group or a bank (G-SIBs) that is not a G-SII and that is included in the list of G-SIBs published by the Financial Stability Board, as regularly updated;

“third-country reinsurance undertaking” has the meaning given in regulation 3(1) of the Financial Services (Insurance Companies) Regulations 2020;

“Tier 1 own-fund insurance items” means basic own-fund items of insurance and reinsurance undertakings where those items are classified in Tier 1 in accordance with regulation 86(1) of the Financial Services (Insurance Companies) Regulations 2020;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

"Tier 2 own-fund insurance items" means basic own-fund items of insurance and reinsurance undertakings where those items are classified in Tier 2 in accordance with regulation 86(2) of the Financial Services (Insurance Companies) Regulations 2020;

"Tier 3 own-fund insurance items" means basic own-fund insurance items of insurance and reinsurance undertakings where those items are classified in Tier 3 in accordance with regulation 86(3) of the Financial Services (Insurance Companies) Regulations 2020;

"trade exposure" means a current exposure, including a variation margin due to the clearing member but not yet received, and any potential future exposure of a clearing member or a client, to a CCP arising from contracts and transactions listed in Article 301(1), as well as initial margin;

"trade finance" means financing, including guarantees, connected to the exchange of goods and services through financial products of fixed short-term maturity, generally of less than one year, without automatic rollover;

"trading book" means all positions in financial instruments and commodities held by an institution either with trading intent or to hedge positions held with trading intent in accordance with Article 104;

"trading desk" means a well-identified group of dealers set up by the institution to jointly manage a portfolio of trading book positions in accordance with a well-defined and consistent business strategy and operating under the same risk management structure;

"tranche" means a tranche as defined in Article 2(6) of the Securitisation Regulation;

"UK-adopted international accounting standards" has the meaning given in section 237 of the Companies Act 2014;

"unfunded credit protection" means a technique of credit risk mitigation where the reduction of the credit risk on the exposure of an institution derives from the obligation of a third party to pay an amount in the event of the default of the borrower or the occurrence of other specified credit events.

(1A) In these Regulations a reference to an EU Regulation is to that Regulation as it forms part of the law of Gibraltar.

(2) [Not used]

(3) Trade finance as defined in paragraph (1) is generally uncommitted and requires satisfactory supporting transactional documentation for each drawdown request enabling

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

refusal of the finance in the event of any doubt about creditworthiness or the supporting transactional documentation. Repayment of trade finance exposures is usually independent of the borrower, the funds instead coming from cash received from importers or resulting from proceeds of the sales of the underlying goods.

(4) [Not used]

Definitions specific to capital requirements for credit risk.

5. For the purposes of Title 2 of Part 3, the following definitions apply–

(a) "exposure" means an asset or off-balance sheet item;

(b) "loss" means economic loss, including material discount effects, and material direct and indirect costs associated with collecting on the instrument;

(c) "expected loss" or "EL" means the ratio of the amount expected to be lost on an exposure from a potential default of a counterparty or dilution over a one-year period to the amount outstanding at default.

GFSC approvals.

5A.(1) Subject to paragraph (4), a reference in these Standards to the need for GFSC approval means written approval from the GFSC allowing the person to whom it is given to–

(a) not apply a provision of these Standards; or

(b) apply such a provision with the modifications specified in the approval.

(2) An application for approval under paragraph (1) must–

(a) be made in the form and manner the GFSC directs; and

(b) contain or accompanied by any information the GFSC may reasonably require.

(3) The GFSC may–

(a) give approval under paragraph (1) subject to conditions; and

(b) revoke or vary approval given under paragraph (1).

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(4) Where a provision in these Standards refers to the need for GFSC Art. 5A(4) approval it means written approval from the GFSC given in accordance with paragraphs (5) to (9).

(5) An application for Art. 5A(4) approval must–

(a) be made in the form and manner the GFSC directs; and

(b) contain or accompanied by any information the GFSC may reasonably require,

and the GFSC may specify a different form or manner or different information for different provisions or purposes.

(6) Where the GFSC gives an Art. 5A(4) approval, it must give the person concerned a written notice stating–

(a) that the approval is given;

(b) the conditions (if any) to which the approval is subject;

(c) unless the person concerned consents to those conditions (if any), the reasons on which the decision is based; and

(d) the date on which the approval takes effect.

(7) Where the GFSC refuses an Art. 5A(4) approval, it must give the person concerned a written notice stating–

(a) that the approval is refused;

(b) the reasons on which the decision is based; and

(c) the date on which the decision takes effect.

(8) Where the GFSC varies or revokes an Art. 5A(4) approval, it must give the person concerned a written notice stating–

(a) that the approval is varied or revoked;

(b) if the approval is varied, the conditions (if any) to which the approval is subject;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(c) unless the person concerned consents to the variation or revocation (including any conditions to which the approval is subject), the reasons on which the decision is based; and

(d) the date on which the variation or revocation takes effect.

(9) The GFSC, on the application or with the consent of a person who is given an Art. 5A(4) approval, may specify within that approval provisions of these Standards which the person–

(a) is not required to apply; or

(b) is to apply subject to modifications specified in the approval,

where the GFSC is satisfied that requiring the specified provisions to apply (either at all or without modification) is incompatible with the approval.

TITLE 2
LEVEL OF APPLICATION OF REQUIREMENTS

CHAPTER 1
APPLICATION OF REQUIREMENTS ON AN INDIVIDUAL BASIS

General principles.

6.(1) Institutions must comply with the obligations in Parts 2, 3, 4, 7, 7A and 8 and in Chapter 2 of the Securitisation Regulation on an individual basis, with the exception of Article 430(1)(d).

(1A) By way of derogation from paragraph (1), only institutions identified as resolution entities that are also G-SIIs or that are part of a G-SII, and that do not have subsidiaries must comply with the requirement in Article 92A on an individual basis.

Material subsidiaries of a third-country G-SII must comply with Article 92B on an individual basis, where they meet all the following conditions–

(a) they are not resolution entities;

(b) they do not have subsidiaries;

(c) they are not the subsidiaries of a Gibraltar parent institution.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(2) An institution which is either a subsidiary authorised and supervised in Gibraltar, or a parent undertaking, or an institution included in the consolidation pursuant to Article 18, is not required to comply with the obligations laid down in Articles 89, 90 and 91 on an individual basis.

(3) An institution which is either a parent undertaking or a subsidiary, or an institution included in the consolidation pursuant to Article 18, is not required to comply with the obligations laid down in Part 8 on an individual basis.

Despite the preceding sub-paragraph, the institutions referred to in paragraph (1A) must comply with Articles 437A and 447(h) on an individual basis.

(4) Institutions must comply with the obligations in Part 6 and Article 430(1)(d) on an individual basis.

The following institutions are not required to comply with Article 413(1) and the associated liquidity reporting requirements in Part 7A–

(a) institutions which are also authorised in accordance with Article 14 of EMIR;

(b) institutions which are also authorised in accordance with Articles 16 and 54(2)(a) of the CSD Regulation and which do not perform any significant maturity transformations; and

(c) institutions which are designated in accordance with Article 54(2)(b) of the CSD Regulation–

(i) the activities of which are limited to offering banking-type services of the kind in Section C of the Annex to that Regulation to central securities depositories authorised in accordance with Article 16 of that Regulation; and

(ii) which do not perform any significant maturity transformations.

(5) Institutions for which the GFSC has exercised the derogation in Article 7(1) or 7(3), and institutions which are also authorised in accordance with Article 14 of EMIR, are not required to comply with the obligations in Part 7 and the associated leverage ratio reporting requirements in Part 7A on an individual basis.

Derogation from the application of prudential requirements on an individual basis.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

7.(1) The GFSC may waive the application of Article 6(1) to any subsidiary of an institution, where both the subsidiary and the institution are subject to authorisation and supervision in Gibraltar, and the subsidiary is included in the supervision on a consolidated basis of the institution which is the parent undertaking, and all of the following conditions are satisfied, in order to ensure that own funds are distributed adequately between the parent undertaking and the subsidiary–

(a) there is no current or foreseen material practical or legal impediment to the prompt transfer of own funds or repayment of liabilities by its parent undertaking;

(b) either the parent undertaking satisfies the GFSC regarding the prudent management of the subsidiary and has declared, with the GFSC's approval, that it guarantees the commitments entered into by the subsidiary, or the risks in the subsidiary are of negligible interest;

(c) the risk evaluation, measurement and control procedures of the parent undertaking cover the subsidiary;

(d) the parent undertaking holds more than 50% of the voting rights attached to shares in the capital of the subsidiary or has the right to appoint or remove a majority of the members of the management body of the subsidiary.

(2) The GFSC may exercise the option provided for in paragraph (1) where the parent undertaking of the subsidiary is a Gibraltar financial holding company or a Gibraltar mixed financial holding company, if it is subject to the same supervision as that exercised over institutions, and in particular to the standards laid down in Article 11(1).

(3) The GFSC may waive the application of Article 6(1) to a Gibraltar parent institution, where it is included in the supervision on a consolidated basis, and all the following conditions are satisfied, in order to ensure that own funds are distributed adequately among the parent undertaking and the subsidiaries–

(a) there is no current or foreseen material practical or legal impediment to the prompt transfer of own funds or repayment of liabilities to the Gibraltar parent institution;

(b) the risk evaluation, measurement and control procedures relevant for consolidated supervision cover the Gibraltar parent institution.

Derogation from the application of liquidity requirements on an individual basis.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

8.(1) The GFSC may waive in full or in part the application of Part 6 to an institution and to all or some of its subsidiaries in Gibraltar and supervise them as a single liquidity sub-group so long as they fulfil all of the following conditions–

(a) the parent institution on a consolidated basis or a subsidiary institution on a sub-consolidated basis complies with the obligations laid down in Part 6;

(b) the parent institution on a consolidated basis or the subsidiary institution on a sub-consolidated basis–

(i) monitors and has oversight at all times over the liquidity positions of all institutions within the group or sub-group that are subject to the waiver and over the funding positions of all institutions within the group or sub-group where the net stable funding ratio (NSFR) requirement set out in Title 4 of Part 6 is waived; and

(ii) ensures a sufficient level of liquidity, and of stable funding where the NSFR requirement set out in Title 4 of Part 6 is waived, for all of those institutions;

(c) the institutions have entered into contracts that, to the satisfaction of the GFSC, provide for the free movement of funds between them to enable them to meet their individual and joint obligations as they become due;

(d) there is no current or foreseen material practical or legal impediment to the fulfilment of the contracts referred to in sub-paragraph (c).

(2) to (4) [Not used]

(5) Where a waiver has been granted under paragraph (1), the GFSC may also–

(a) apply all or part of regulation 43 of the CICR Regulations at the level of the single liquidity sub-group; and

(b) waive the application of all or part of regulation 43 of the CICR Regulations on an individual basis.

(6) Where, in accordance with this Article, the GFSC waives, in part or in full, the application of Part 6 to an institution, it may also waive the application of the associated liquidity reporting requirements under Article 430(1)(d) for that institution.

Individual consolidation method.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

9.(1) Subject to paragraph (2) and to regulation 174(3) of the CICR Regulations, the GFSC may permit on a case-by-case basis parent institutions to incorporate in the calculation of their requirement under Article 6(1), subsidiaries which meet the conditions laid down in Article 7(1)(c) and (d) and whose material exposures or material liabilities are to that parent institution.

(2) The treatment set out in paragraph (1) is permitted only where the parent institution demonstrates fully to the GFSC the circumstances and arrangements, including legal arrangements, by virtue of which there is no current or foreseen material practical or legal impediment to the prompt transfer of own funds, or repayment of liabilities when due by the subsidiary to its parent undertaking.

10. [Not used]

Application of prudential requirements on a consolidated basis where investment firms are parent undertakings.

10A. For the purposes of the application of this Chapter, an investment firm is considered to be a Gibraltar parent financial holding company where it is the parent undertaking of an institution (including of an investment firm to which Article 2(4) applies).

CHAPTER 2
PRUDENTIAL CONSOLIDATION

Application of requirements on a consolidated basis

General treatment.

11.(1) Gibraltar parent institutions must comply, to the extent and in the manner set out in Article 18, with the obligations laid down in Parts 2, 3, 4, 7 and 7A on the basis of their consolidated situation, with the exception of Article 430(1)(d). The parent undertakings and their subsidiaries that are subject to these Standards must set up a proper organisational structure and appropriate internal control mechanisms in order to ensure that the data required for consolidation are duly processed and forwarded. In particular, they must ensure that subsidiaries not subject to these Standards implement arrangements, processes and mechanisms to ensure proper consolidation.

(2) For the purpose of ensuring that the requirements of these Standards are applied on a consolidated basis, the terms "institution", "Gibraltar parent institution" and "parent undertaking", as the case may be, also refer to–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) a financial holding company or mixed financial holding company approved in accordance with regulation 16A of the CICR Regulations;

(b) a designated institution controlled by a parent financial holding company or parent mixed financial holding company where such a parent is not subject to approval in accordance with regulation 16A(5) of the CICR Regulations;

(c) a financial holding company, mixed financial holding company or institution designated in accordance with regulation 16A(12)(d) of the CICR Regulations.

The consolidated situation of an undertaking referred to in sub-paragraph (b) must be the consolidated situation of the parent financial holding company or the parent mixed financial holding company that is not subject to approval in accordance with regulation 16A(5) of the CICR Regulations. The consolidated situation of an undertaking referred to in sub-paragraph (c) must be the consolidated situation of its parent financial holding company or parent mixed financial holding company.

(3) [Not used]

(3A) By way of derogation from paragraph (1), only parent institutions identified as resolution entities that are G-SIIs, part of a G-SII or part of a third-country G-SII must comply with Article 92A on a consolidated basis, to the extent and in the manner set out in Article 18.

Only Gibraltar parent undertakings that are a material subsidiary of a third-country G-SII and are not resolution entities must comply with Article 92B on a consolidated basis to the extent and in the manner set out in Article 18.

(4) Gibraltar parent institutions must comply with Part 6 and Article 430(1)(d) on the basis of their consolidated situation where the group comprises one or more credit institutions or investment firms that are authorised to provide the investment services and activities listed in paragraphs 50 and 53 of Schedule 2 to the Act.

Where a waiver has been granted under Article 8(1), the institutions and, where applicable, the financial holding companies or mixed financial holding companies that are part of a liquidity sub-group must comply with Part 6 and Article 430(1)(d) on a consolidated basis or on the sub-consolidated basis of the liquidity sub-group.

(5) [Not used]

(6) In addition to the requirements of paragraphs (1) and (2), the GFSC may require an institution to comply with the obligations mentioned in the third sub-paragraph on a sub-consolidated basis where–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) it is justified for supervisory purposes by the specificities of the risk or the capital structure of the institution, or

(b) the law of Gibraltar requires the structural separation of activities within a banking group.

Applying the approach set out in the first sub-paragraph must be without prejudice to effective supervision on a consolidated basis.

The obligations mentioned in this paragraph are those provided for in–

(a) Parts 2 to 4 and 6 to 8; and

(b) Chapter 3 of Part 5 of the CICR Regulations.

12. [Not used]

Consolidated calculation for G-SIIs with multiple resolution entities

12A. Where at least two G-SII entities belonging to the same G-SII are resolution entities, the Gibraltar parent institution of that G-SII must calculate the amount of own funds and eligible liabilities referred to in Article 92A(1)(a). That calculation must be undertaken on the basis of the consolidated situation of the Gibraltar parent institution as if it were the only resolution entity of the G-SII.

Application of disclosure requirements on a consolidated basis.

13.(1) A Gibraltar parent institution must comply with Part 8 on the basis of its consolidated situation.

(2) Large subsidiaries of Gibraltar parent institutions, Gibraltar parent financial holding companies or Gibraltar parent mixed financial holding companies and large subsidiaries of parent undertakings established in a third country must disclose the information specified in Articles 437, 438, 440, 442, 450, 451A and 453 on an individual basis or, where applicable in accordance with these Standards and the CICR Regulations, on a sub-consolidated basis.

(3) Paragraph (1) does not apply to a consolidation entity or a resolution entity where it is included in an equivalent disclosure on a consolidated basis provided by a parent undertaking established in a third country.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Application of requirements of Article 5 of the Securitisation Regulation on a consolidated basis.

14.(1) Parent undertakings and their subsidiaries that are subject to these Standards are required to meet the obligations laid down in Article 5 of the Securitisation Regulation on a consolidated or sub-consolidated basis, to ensure that their arrangements, processes and mechanisms required by those provisions are consistent and well-integrated and that any data and information relevant to the purpose of supervision can be produced. In particular, they must ensure that subsidiaries that are not subject to these Standards implement arrangements, processes and mechanisms to ensure compliance with those provisions.

(2) Institutions must apply an additional risk weight in accordance with Article 270A when applying Article 92 on a consolidated or sub-consolidated basis if the requirements laid down in Article 5 of the Securitisation Regulation are breached at the level of an entity established in a third country included in the consolidation in accordance with Article 18 if the breach is material in relation to the overall risk profile of the group.

15. to 17. [Not used]

Methods for prudential consolidation

Methods of prudential consolidation.

18.(1) Institutions, financial holding companies and mixed financial holding companies that are required to comply with the requirements referred to in Articles 11 to 17 on the basis of their consolidated situation must carry out a full consolidation of all institutions and financial institutions that are their subsidiaries. Paragraphs (3) to (6) and paragraph (9) do not apply where Part 6 and Article 430(1)(d) apply on the basis of the consolidated situation of an institution, financial holding company or mixed financial holding company or on the sub-consolidated situation of a liquidity sub-group as set out in Articles 8 and 10.

For the purposes of Article 11(3a), institutions that are required to comply with the requirements referred to in Article 92A or 92B on a consolidated basis must carry out a full consolidation of all institutions and financial institutions that are their subsidiaries in the relevant resolution groups.

(2) Ancillary services undertakings must be included in consolidation in the cases, and in accordance with the methods, laid down in this Article.

(3) Where undertakings are related by a common management relationship, the GFSC may determine how consolidation is to be carried out.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(4) The GFSC as consolidating supervisor may require the proportional consolidation according to the share of capital held of participations in institutions and financial institutions managed by an undertaking included in the consolidation together with one or more undertakings not included in the consolidation, where the liability of those undertakings is limited to the share of the capital they hold.

(5) In the case of participations or capital ties other than those referred to in paragraphs (1) and (4), the GFSC may determine whether and how consolidation is to be carried out. In particular, it may permit or require the use of the equity method. That method does not, however, constitute inclusion of the undertakings concerned in supervision on a consolidated basis.

(6) The GFSC may determine whether and how consolidation is to be carried out in the following cases–

(a) where, in the opinion of the GFSC, an institution exercises a significant influence over one or more institutions or financial institutions, but without holding a participation or other capital ties in those institutions; and

(b) where two or more institutions or financial institutions are placed under single management other than pursuant to a contract, clauses of their memoranda or articles of association.

In particular, the GFSC may permit or require the use of the method used by undertakings that are linked by a common management relationship. That method does not, however, constitute inclusion of the undertakings concerned in consolidated supervision.

(7) [Not used]

By way of derogation from the first sub-paragraph, the GFSC may allow or require institutions to apply a different method to such subsidiaries or participations, including the method required by the applicable accounting framework, if–

(a) the institution does not already apply the equity method on 28 December 2020;

(b) it would be unduly burdensome to apply the equity method or the equity method does not adequately reflect the risks that the undertaking referred to in the first sub-paragraph poses to the institution; and

(c) the method applied does not result in full or proportional consolidation of that undertaking.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(8) The GFSC may require full or proportional consolidation of a subsidiary or an undertaking in which an institution holds a participation where that subsidiary or undertaking is not an institution, financial institution or ancillary services undertaking and where all the following conditions are met–

(a) the undertaking is not an insurance undertaking, a third-country insurance undertaking, a reinsurance undertaking, a third-country reinsurance undertaking, an insurance holding company or an undertaking excluded from the scope of the Financial Services (Insurance Companies) Regulations 2020 in accordance with regulation 5 of those Regulations;

(b) there is a substantial risk that the institution decides to provide financial support to that undertaking in stressed conditions, in the absence of, or in excess of any contractual obligations to provide such support.

Scope of prudential consolidation

Entities excluded from the scope of prudential consolidation.

19.(1) An institution, a financial institution or an ancillary services undertaking which is a subsidiary or an undertaking in which a participation is held, need not to be included in the consolidation where the total amount of assets and off-balance sheet items of the undertaking concerned is less than the smaller of the following two amounts–

(a) €10 million;

(b) 1% of the total amount of assets and off-balance sheet items of the parent undertaking or the undertaking that holds the participation.

(2) The GFSC as consolidating supervisor may on a case-by-case basis decide in the following cases that an institution, financial institution or ancillary services undertaking which is a subsidiary or in which a participation is held need not be included in the consolidation–

(a) where the undertaking concerned is situated in a third country where there are legal impediments to the transfer of the necessary information;

(b) where the undertaking concerned is of negligible interest only with respect to the objectives of monitoring institutions;

(c) where, in the opinion of the GFSC, the consolidation of the financial situation of the undertaking concerned would be inappropriate or misleading as far as the objectives of the supervision of institutions are concerned.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(3) Where, in the cases referred to in paragraph (1) and paragraph (2)(b), several undertakings meet the criteria set out therein, they must nevertheless be included in the consolidation where collectively they are of non-negligible interest with respect to the specified objectives.

Decisions on prudential requirements.

20. Where a Gibraltar parent institution and its subsidiaries, the subsidiaries of a Gibraltar parent financial holding company or a Gibraltar parent mixed financial holding company use an Advanced Measurement Approach referred to in Article 312(2) or an IRB Approach referred to in Article 143 on a unified basis, the GFSC must allow the qualifying criteria set out in Articles 321 and 322 or in Articles 169 to 191 respectively to be met by the parent and its subsidiaries considered together, in a way that is consistent with the structure of the group and its risk management systems, processes and methodologies.

21. [Not used]

Sub-consolidation in cases of entities in third countries.

22.(1) Subsidiary institutions must apply the requirements in Articles 89, 90 and 91 and Parts 3, 4 and 7 and the associated reporting requirements in Part 7A on the basis of their sub-consolidated situation if those institutions have an institution or a financial institution as a subsidiary in a third country, or hold a participation in such an undertaking.

(2) Despite paragraph (1), subsidiary institutions may choose not to apply the requirements in Articles 89, 90 and 91 and Parts 3, 4 and 7 and the associated reporting requirements in Part 7A on the basis of their sub-consolidated situation where the total assets and off-balance-sheet items of their subsidiaries and participations in third countries are less than 10% of the total amount of the assets and off-balance-sheet items of the subsidiary institution.

Undertakings in third countries.

23. For the purposes of applying supervision on a consolidated basis in accordance with this Chapter, the terms "investment firm", "credit institution", "financial institution", and "institution" also apply to undertakings established in third countries, which, were they established in Gibraltar, would fulfil the definitions of those terms in Article 4.

Valuation of assets and off-balance sheet items.

24.(1) The valuation of assets and off-balance sheet items must be effected in accordance with the applicable accounting framework.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(2) By way of derogation from paragraph (1), the GFSC may require that institutions effect the valuation of assets and off-balance sheet items and the determination of own funds in accordance with UK-adopted international accounting standards.

PART 2
OWN FUNDS AND ELIGIBLE LIABILITIES

TITLE 1
ELEMENTS OF OWN FUNDS

CHAPTER 1
TIER 1 CAPITAL

Tier 1 capital.

25. The Tier 1 capital of an institution consists of the sum of the Common Equity Tier 1 capital and Additional Tier 1 capital of the institution.

CHAPTER 2
COMMON EQUITY TIER 1 CAPITAL

Common Equity Tier 1 items and instruments

Common Equity Tier 1 items.

26.(1) Common Equity Tier 1 items of institutions consist of the following–

(a) subject to paragraph (3), capital instruments, if the conditions laid down in Article 28 or, where applicable, Article 29 are met;

(b) share premium accounts related to the instruments referred to in sub-paragraph (a);

(c) retained earnings;

(d) accumulated other comprehensive income; and

(e) other reserves.

The items referred to in sub-paragraphs (c) to (e) must be recognised as Common Equity Tier 1 only where they are available to the institution for unrestricted and immediate use to cover risks or losses as soon as these occur.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(2) For the purposes of paragraph (1)(c), institutions must not include interim or year-end profits in Common Equity Tier 1 capital before the institution has taken a formal decision confirming the final profit or loss of the institution for the year unless–

(a) those profits have been verified by persons independent of the institution that are responsible for the auditing of the accounts of that institution; and

(b) the institution has ensured that any foreseeable charge or dividend has been deducted from the amount of those profits.

A verification of the interim or year-end profits of the institution must provide an adequate level of assurance that those profits have been evaluated in accordance with the principles set out in the applicable accounting framework.

Where the institution includes, pursuant to this paragraph, profits in Common Equity Tier 1 capital, it must notify the GFSC as soon as reasonably practicable.

(3) Institutions must not classify issuances of capital instruments as Common Equity Tier 1 instruments unless–

(a) GFSC Art. 5A(4) approval has been granted; and

(b) the conditions in Article 28 or, where applicable, Article 29 are met.

By way of derogation from the first sub-paragraph, institutions may classify as Common Equity Tier 1 instruments subsequent issuances of a form of Common Equity Tier 1 instruments for which they have already received GFSC Art. 5A(4) approval, if the provisions governing those subsequent issuances are identical or substantially the same as the provisions governing those issuances for which the institutions have already received GFSC Art. 5A(4) approval.

Capital instruments of mutuals, cooperative societies, savings institutions or similar institutions in Common Equity Tier 1 items.

27.(1) Common Equity Tier 1 items must not include any capital instrument issued by an institution of a type referred to below unless the conditions laid down in Article 28 or, where applicable, Article 29 are met.

The institution is of a type that is defined under the applicable law of Gibraltar as any of the following–

(a) a mutual;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(b) a cooperative society;

(c) a savings institution;

(d) a similar institution;

(e) a credit institution which is wholly owned by one of the institutions referred to in sub-paragraphs (a) to (d) and has approval from the GFSC to make use of the provisions in this Article, if and for as long as 00% of the ordinary shares in issue in the credit institution are held directly or indirectly by an institution referred to in those sub-paragraphs.

(2) Those mutuals, cooperative societies or savings institutions recognised as such under the applicable law of Gibraltar prior to 31 December 2012 must continue to be classified as such for the purposes of this Part, if they continue to meet the criteria that determined such recognition.

Common Equity Tier 1 instruments.

28.(1) Capital instruments must qualify as Common Equity Tier 1 instruments only if all the following conditions are met–

(a) the instruments are issued directly by the institution with the prior approval of the owners of the institution or, where permitted under the applicable law of Gibraltar or a third country, the management body of the institution;

(b) the instruments are fully paid up and the acquisition of ownership of those instruments is not funded directly or indirectly by the institution, and for this purpose only the part of a capital instrument that is fully paid up must be eligible to qualify as a Common Equity Tier 1 instrument;

(c) the instruments meet all the following conditions as regards their classification–

(i) they qualify as capital, which for these purposes comprises all amounts, regardless of their actual designations, which, in accordance with the legal structure of the institution concerned, are regarded under the applicable law of Gibraltar or a third country, as equity capital subscribed by the shareholders or other proprietors;

(ii) they are classified as equity within the meaning of the applicable accounting framework;

(iii) they are classified as equity capital for the purposes of determining balance sheet insolvency, where applicable under the insolvency laws of Gibraltar or a third country;

(d) the instruments are clearly and separately disclosed on the balance sheet in the financial statements of the institution;

(e) the instruments are perpetual;

(f) the principal amount of the instruments may not be reduced or repaid, except in either of the following cases–

(i) the liquidation of the institution;

(ii) discretionary repurchases of the instruments or other discretionary means of reducing capital, where the institution has received GFSC Art. 5A(4) approval in accordance with Article 77;

(g) the provisions governing the instruments do not indicate expressly or implicitly that the principal amount of the instruments would or might be reduced, redeemed, repurchased or repaid (other than in the circumstances describes in sub-paragraphs (f)(i) and (f)(ii)), and the institution does not otherwise provide such an indication prior to or at issuance of the instruments, except in the case of instruments referred to in Article 27 where the refusal by the institution to redeem such instruments is prohibited under the applicable law of Gibraltar or a third country;

(h) the instruments meet the following conditions as regards distributions–

(i) there is no preferential distribution treatment regarding the order of distribution payments, including in relation to other Common Equity Tier 1 instruments, and the terms governing the instruments do not provide preferential rights to payment of distributions;

(ii) distributions to holders of the instruments may be paid only out of distributable items;

(iii) the conditions governing the instruments do not include a cap or other restriction on the maximum level of distributions, except in the case of the instruments referred to in Article 27;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(iv) the level of distributions is not determined on the basis of the amount for which the instruments were purchased at issuance, except in the case of the instruments referred to in Article 27;

(v) the conditions governing the instruments do not include any obligation for the institution to make distributions to their holders and the institution is not otherwise subject to such an obligation;

(vi) non-payment of distributions does not constitute an event of default of the institution;

(vii) the cancellation of distributions imposes no restrictions on the institution;

(i) compared to all the own funds instruments issued by the institution, the instruments absorb the first and proportionately greatest share of losses as they occur, and each instrument absorbs losses to the same degree as all other Common Equity Tier 1 instruments;

(j) the instruments rank below all other claims in the event of insolvency or liquidation of the institution, except claims from holders of ordinary shares which rank *pari passu* with the instruments;

(k) the instruments entitle their owners to a claim on the residual assets of the institution, which, in the event of its liquidation and after the payment of all senior claims, is proportionate to the amount of such instruments issued and is not fixed or subject to a cap, except in the case of the capital instruments referred to in Article 27 and, for the purposes of this sub-paragraph, a claim that is specified in terms of a percentage does not constitute a fixed or capped claim;

(l) the instruments are neither secured nor subject to a guarantee that enhances the seniority of the claim by any of the following–

(i) the institution or its subsidiaries;

(ii) the parent undertaking of the institution or its subsidiaries;

(iii) the parent financial holding company of the institution or its subsidiaries;

(iv) the mixed activity holding company of the institution or its subsidiaries;

(v) the mixed financial holding company of the institution or its subsidiaries;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(vi) any undertaking that has close links with the entities referred to in paragraphs (i) to (v);

(m) the instruments are not subject to any arrangement, contractual or otherwise, that enhances the seniority of claims under the instruments in insolvency or liquidation.

(2) The conditions laid down in paragraph (1)(i) must be deemed to be met despite a write down on a permanent basis of the principal amount of Additional Tier 1 or Tier 2 instruments.

The condition laid down in paragraph (1)(f) must be deemed to be met despite the reduction of the principal amount of the capital instrument within a resolution procedure or as a consequence of a write down of capital instruments required by the resolution authority responsible for the institution.

The condition laid down in paragraph (1)(g) must be deemed to be met despite the provisions governing the capital instrument indicating expressly or implicitly that the principal amount of the instrument would be reduced within a resolution procedure or as a consequence of a write down of capital instruments required by the resolution authority responsible for the institution.

(3) The condition laid down in paragraph (1)(h)(iii) must be deemed to be met despite the instrument paying a dividend multiple, if such a dividend multiple does not result in a distribution that causes a disproportionate drag on own funds.

(4) For the purposes of paragraph (1)(h)(i), differentiated distributions must only reflect differentiated voting rights. In this respect, higher distributions must only apply to Common Equity Tier 1 instruments with fewer or no voting rights.

Capital instruments issued by mutuals, cooperative societies, savings institutions and similar institutions.

29.(1) Capital instruments issued by mutuals, cooperative societies, savings institutions and similar institutions must qualify as Common Equity Tier 1 instruments only if the conditions laid down in Article 28 with modifications resulting from the application of this Article are met.

(2) The following conditions must be met as regards redemption of the capital instruments–

(a) except where prohibited under the applicable law of Gibraltar or a third country, the institution must be able to refuse the redemption of the instruments;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(b) where the refusal by the institution of the redemption of instruments is prohibited under the applicable law of Gibraltar or a third country, the provisions governing the instruments must give the institution the ability to limit their redemption;

(c) refusal to redeem the instruments, or the limitation of the redemption of the instruments where applicable, may not constitute an event of default of the institution.

(3) The capital instruments may include a cap or restriction on the maximum level of distributions only where that cap or restriction is set out under the applicable law of Gibraltar or a third country or the statute of the institution.

(4) Where the capital instruments provide the owner with rights to the reserves of the institution in the event of insolvency or liquidation that are limited to the nominal value of the instruments, such a limitation must apply to the same degree to the holders of all other Common Equity Tier 1 instruments issued by that institution.

The condition laid down in the first sub-paragraph is without prejudice to the possibility for a mutual, cooperative society, savings institution or a similar institution to recognise within Common Equity Tier 1 instruments that do not afford voting rights to the holder and that meet all the following conditions–

(a) the claim of the holders of the non-voting instruments in the insolvency or liquidation of the institution is proportionate to the share of the total Common Equity Tier 1 instruments that those non-voting instruments represent;

(b) the instruments otherwise qualify as Common Equity Tier 1 instruments.

(5) Where the capital instruments entitle their owners to a claim on the assets of the institution in the event of its insolvency or liquidation that is fixed or subject to a cap, such a limitation must apply to the same degree to all holders of all Common Equity Tier 1 instruments issued by the institution.

Consequences of the conditions for Common Equity Tier 1 instruments ceasing to be met.

30. The following applies where, in the case of a Common Equity Tier 1 instrument, the conditions laid down in Article 28 or, where applicable, Article 29 cease to be met–

(a) that instrument must immediately cease to qualify as a Common Equity Tier 1 instrument;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(b) the share premium accounts that relate to that instrument must immediately cease to qualify as Common Equity Tier 1 items.

31. [Not used]

Prudential filters

Securitised assets.

32. An institution must exclude from any element of own funds any increase in its equity under the applicable accounting framework that results from securitised assets, including the following–

(a) such an increase associated with future margin income that results in a gain on sale for the institution;

(b) where the institution is the originator of a securitisation, net gains that arise from the capitalisation of future income from the securitised assets that provide credit enhancement to positions in the securitisation.

Cash flow hedges and changes in the value of own liabilities.

33.(1) Institutions must not include the following items in any element of own funds–

(a) the fair value reserves related to gains or losses on cash flow hedges of financial instruments that are not valued at fair value, including projected cash flows;

(b) gains or losses on liabilities of the institution that are valued at fair value that result from changes in the own credit standing of the institution;

(c) fair value gains and losses on derivative liabilities of the institution that result from changes in the own credit risk of the institution.

(2) For the purposes of paragraph (1)(c), institutions must not offset the fair value gains and losses arising from the institution's own credit risk with those arising from its counterparty credit risk.

(3) Without prejudice to paragraph (1)(b), institutions may include the amount of gains and losses on their liabilities in own funds where all the following conditions are met–

(a) the liabilities are CRR covered bonds;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(b) the changes in the value of the institution's assets and liabilities are due to the same changes in the institution's own credit standing;

(c) there is a close correspondence between the value of the bonds referred to in sub-paragraph (a) and the value of the institution's assets;

(d) it is possible to redeem the mortgage loans by buying back the bonds financing the mortgage loans at market or nominal value.

Additional value adjustments.

34. Institutions must apply the requirements of Article 105 to all their assets measured at fair value when calculating the amount of their own funds and deduct from Common Equity Tier 1 capital the amount of any additional value adjustments necessary.

Unrealised gains and losses measured at fair value.

35. Except in the case of the items referred to in Article 33, institutions must not make adjustments to remove from their own funds unrealised gains or losses on their assets or liabilities measured at fair value.

Deductions from Common Equity Tier 1 items, exemptions and alternatives

Deductions from Common Equity Tier 1 items.

36.(1) Institutions must deduct the following from Common Equity Tier 1 items–

(a) losses for the current financial year;

(b) intangible assets;

(c) deferred tax assets that rely on future profitability;

(d) for institutions calculating risk-weighted exposure amounts using the Internal Ratings Based Approach (the IRB Approach), negative amounts resulting from the calculation of expected loss amounts laid down in Articles 158 and 159;

(e) defined benefit pension fund assets on the balance sheet of the institution;

(f) direct, indirect and synthetic holdings by an institution of own Common Equity Tier 1 instruments, including own Common Equity Tier 1 instruments that an

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

institution is under an actual or contingent obligation to purchase by virtue of an existing contractual obligation;

(g) direct, indirect and synthetic holdings of the Common Equity Tier 1 instruments of financial sector entities where those entities have a reciprocal cross holding with the institution that the competent authority considers to have been designed to inflate artificially the own funds of the institution;

(h) the applicable amount of direct, indirect and synthetic holdings by the institution of Common Equity Tier 1 instruments of financial sector entities where the institution does not have a significant investment in those entities;

(i) the applicable amount of direct, indirect and synthetic holdings by the institution of the Common Equity Tier 1 instruments of financial sector entities where the institution has a significant investment in those entities;

(j) the amount of items required to be deducted from Additional Tier 1 items pursuant to Article 56 that exceeds the Additional Tier 1 items of the institution;

(k) the exposure amount of the following items which qualify for a risk weight of 1,250%, where the institution deducts that exposure amount from the amount of Common Equity Tier 1 items as an alternative to applying a risk weight of 1,250%–

(i) qualifying holdings outside the financial sector;

(ii) securitisation positions, in accordance with Article 244(1)(b), Article 245(1)(b) and Article 253;

(iii) free deliveries, in accordance with Article 379(3);

(iv) positions in a basket for which an institution cannot determine the risk weight under the IRB Approach, in accordance with Article 153(8);

(v) equity exposures under an internal models approach, in accordance with Article 155(4);

(l) any tax charge relating to Common Equity Tier 1 items foreseeable at the moment of its calculation, except where the institution suitably adjusts the amount of Common Equity Tier 1 items so far as such tax charges reduce the amount up to which those items may be used to cover risks or losses.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(2) [Not used]

Deduction of intangible assets.

37. Institutions must determine the amount of intangible assets to be deducted in accordance with the following–

(a) the amount to be deducted must be reduced by the amount of associated deferred tax liabilities that would be extinguished if the intangible assets became impaired or were derecognised under the applicable accounting framework;

(b) the amount to be deducted must include goodwill included in the valuation of significant investments of the institution;

(c) the amount to be deducted must be reduced by the amount of the accounting revaluation of the subsidiaries' intangible assets derived from the consolidation of subsidiaries attributable to persons other than the undertakings included in the consolidation pursuant to Chapter 2 of Title 2 of Part 1.

Deduction of deferred tax assets that rely on future profitability.

38.(1) Institutions must determine the amount of deferred tax assets that rely on future profitability that require deduction in accordance with this Article.

(2) Except where the conditions laid down in paragraph (3) are met, the amount of deferred tax assets that rely on future profitability must be calculated without reducing it by the amount of the associated deferred tax liabilities of the institution.

(3) The amount of deferred tax assets that rely on future profitability may be reduced by the amount of the associated deferred tax liabilities of the institution, provided the following conditions are met–

(a) the entity has a legally enforceable right under the applicable law of Gibraltar or a third country to set off those current tax assets against current tax liabilities; and

(b) the deferred tax assets and the deferred tax liabilities relate to taxes levied by the same tax authority and on the same taxable entity.

(4) Associated deferred tax liabilities of the institution used for the purposes of paragraph (3) may not include deferred tax liabilities that reduce the amount of intangible assets or defined benefit pension fund assets required to be deducted.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(5) The amount of associated deferred tax liabilities referred to in paragraph (4) must be allocated between the following–

(a) deferred tax assets that rely on future profitability and arise from temporary differences that are not deducted in accordance with Article 48(1);

(b) all other deferred tax assets that rely on future profitability.

Institutions must allocate the associated deferred tax liabilities according to the proportion of deferred tax assets that rely on future profitability that the items referred to in sub-paragraphs (a) and (b) represent.

Tax overpayments, tax loss carry backs and deferred tax assets that do not rely on future profitability.

39.(1) The following items must not be deducted from own funds and are subject to a risk weight in accordance with Chapter 2 or 3 of Title 2 of Part 3, as applicable–

(a) overpayments of tax by the institution for the current year;

(b) current year tax losses of the institution carried back to previous years that give rise to a claim on, or a receivable from, a central government, regional government or local tax authority.

(2) Deferred tax assets that do not rely on future profitability must be limited to deferred tax assets which were created before 23 November 2016 and which arise from temporary differences, where all the following conditions are met–

(a) they are automatically and mandatorily replaced without delay with a tax credit in the event that the institution reports a loss when the annual financial statements of the institution are formally approved, or in the event of liquidation or insolvency of the institution;

(b) an institution is able under the applicable tax law of Gibraltar or a third country to offset a tax credit referred to in sub-paragraph (a) against any tax liability of the institution or any other undertaking included in the same consolidation as the institution for tax purposes under that law or any other undertaking subject to the supervision on a consolidated basis in accordance with Chapter 2 of Title 2 of Part 1;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(c) where the amount of tax credits referred to in sub-paragraph (b) exceeds the tax liabilities referred to in that point, any such excess is replaced without delay with a direct claim on the government of Gibraltar.

Institutions must apply a risk weight of 100% to deferred tax assets where the conditions laid down in sub-paragraphs (a), (b) and (c) are met.

Deduction of negative amounts resulting from the calculation of expected loss amounts.

40. The amount to be deducted in accordance with Article 36(1)(d) must not be reduced by a rise in the level of deferred tax assets that rely on future profitability, or other additional tax effects, that could occur if provisions were to rise to the level of expected losses referred to in Articles 158 and 159.

Deduction of defined benefit pension fund assets.

41. For the purposes of Article 36(1)(e), the amount of defined benefit pension fund assets to be deducted must be reduced by the following–

(a) the amount of any associated deferred tax liability which could be extinguished if the assets became impaired or were derecognised under the applicable accounting framework;

(b) the amount of assets in the defined benefit pension fund which the institution has an unrestricted ability to use, if the institution has received GFSC Art.5A(4) approval.

Those assets used to reduce the amount to be deducted must receive a risk weight in accordance with Chapter 2 or 3 of Title 2 of Part 3, as applicable.

Deduction of holdings of own Common Equity Tier 1 instruments.

42. For the purposes of Article 36(1)(f), institutions must calculate holdings of own Common Equity Tier 1 instruments on the basis of gross long positions subject to the following exceptions–

(a) institutions may calculate the amount of holdings of own Common Equity Tier 1 instruments on the basis of the net long position if both the following conditions are met–

(i) the long and short positions are in the same underlying exposure and the short positions involve no counterparty risk;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(ii) either both the long and the short positions are held in the trading book or both are held in the non-trading book;

(iii) institutions must determine the amount to be deducted for direct, indirect and synthetic holdings of index securities by calculating the underlying exposure to own Common Equity Tier 1 instruments included in those indices;

(b) institutions may net gross long positions in own Common Equity Tier 1 instruments resulting from holdings of index securities against short positions in own Common Equity Tier 1 instruments resulting from short positions in the underlying indices, including where those short positions involve counterparty risk, if both the following conditions are met–

(i) the long and short positions are in the same underlying indices;

(ii) either both the long and the short positions are held in the trading book or both are held in the non-trading book.

Significant investment in a financial sector entity.

43. For the purposes of deduction, a significant investment of an institution in a financial sector entity arises where any of the following conditions is met–

(a) the institution owns more than 10% of the Common Equity Tier 1 instruments issued by that entity;

(b) the institution has close links with that entity and owns Common Equity Tier 1 instruments issued by that entity;

(c) the institution owns Common Equity Tier 1 instruments issued by that entity and the entity is not included in consolidation pursuant to Chapter 2 of Title 2 of Part 1 but is included in the same accounting consolidation as the institution for the purposes of financial reporting under the applicable accounting framework.

Deduction of holdings of Common Equity Tier 1 instruments of financial sector entities and where an institution has a reciprocal cross holding designed artificially to inflate own funds.

44. Institutions must make the deductions referred to in Article 36(1)(g) to (i) in accordance with the following–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) holdings of Common Equity Tier 1 instruments and other capital instruments of financial sector entities must be calculated on the basis of the gross long positions;

(b) Tier 1 own-fund insurance items must be treated as holdings of Common Equity Tier 1 instruments for the purposes of deduction.

Deduction of holdings of Common Equity Tier 1 instruments of financial sector entities.

45. Institutions must make the deductions required by Article 36(1)(h) and (i) in accordance with the following provisions–

(a) they may calculate direct, indirect and synthetic holdings of Common Equity Tier 1 instruments of the financial sector entities on the basis of the net long position in the same underlying exposure if both the following conditions are met–

(i) the maturity date of the short position is either the same as, or later than the maturity date of the long position or the residual maturity of the short position is at least one year;

(ii) either both the long position and the short position are held in the trading book or both are held in the non-trading book;

(b) they must determine the amount to be deducted for direct, indirect and synthetic holdings of index securities by calculating the underlying exposure to the capital instruments of the financial sector entities in those indices.

Deduction of holdings of Common Equity Tier 1 instruments where an institution does not have a significant investment in a financial sector entity.

46.(1) For the purposes of Article 36(1)(h), institutions must calculate the applicable amount to be deducted by multiplying the amount referred to in sub-paragraph (a) by the factor derived from the calculation referred to in sub-paragraph (b)–

(a) the aggregate amount by which the direct, indirect and synthetic holdings by the institution of the Common Equity Tier 1, Additional Tier 1 and Tier 2 instruments of financial sector entities in which the institution does not have a significant investment exceeds 10% of the aggregate amount of Common Equity Tier 1 items of the institution calculated after applying the following to Common Equity Tier 1 items–

(i) Articles 32 to 35;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(ii) the deductions referred to in Article 36(1)(a) to (g), (k)(ii) to (v) and (l), excluding the amount to be deducted for deferred tax assets that rely on future profitability and arise from temporary differences;

(iii) Articles 44 and 45;

(b) the amount of direct, indirect and synthetic holdings by the institution of the Common Equity Tier 1 instruments of those financial sector entities in which the institution does not have a significant investment divided by the aggregate amount of direct, indirect and synthetic holdings by the institution of the Common Equity Tier 1, Additional Tier 1 and Tier 2 instruments of those financial sector entities.

(2) Institutions must exclude underwriting positions held for five working days or fewer from the amount referred to in paragraph (1)(a) and from the calculation of the factor referred to in paragraph (1)(b).

(3) The amount to be deducted pursuant to paragraph (1) must be apportioned across all Common Equity Tier 1 instruments held. Institutions must determine the amount of each Common Equity Tier 1 instrument that is deducted pursuant to paragraph (1) by multiplying the amount specified in sub-paragraph (a) by the proportion specified in sub-paragraph (b)–

(a) the amount of holdings required to be deducted pursuant to paragraph (1);

(b) the proportion of the aggregate amount of direct, indirect and synthetic holdings by the institution of the Common Equity Tier 1 instruments of financial sector entities in which the institution does not have a significant investment represented by each Common Equity Tier 1 instrument held.

(4) The amount of holdings referred to in Article 36(1)(h) that is equal to or less than 10% of the Common Equity Tier 1 items of the institution after applying the provisions laid down in paragraph (1)(a)(i) to (iii) must not be deducted and are subject to the applicable risk weights in accordance with Chapter 2 or 3 of Title 2 of Part 3 and the requirements laid down in Title 4 of Part 3, as applicable.

(5) Institutions must determine the amount of each Common Equity Tier 1 instrument that is risk weighted pursuant to paragraph (4) by multiplying the amount specified in sub-paragraph (a) by the amount specified in sub-paragraph (b)–

(a) the amount of holdings required to be risk weighted pursuant to paragraph (4);

(b) the proportion resulting from the calculation in paragraph (3)(b).

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Deduction of holdings of Common Equity Tier 1 instruments where an institution has a significant investment in a financial sector entity.

47. For the purposes of Article 36(1)(i), the applicable amount to be deducted from Common Equity Tier 1 items must exclude underwriting positions held for five working days or fewer and be determined in accordance with Articles 44, 45 and 48.

47A. [Not used]

Forbearance measures.

47B.(1) Forbearance measure is a concession by an institution towards an obligor that is experiencing or is likely to experience difficulties in meeting its financial commitments. A concession may entail a loss for the lender and must refer to either of the following actions–

(a) a modification of the terms and conditions of a debt obligation, where such modification would not have been granted had the obligor not experienced difficulties in meeting its financial commitments;

(b) a total or partial refinancing of a debt obligation, where such refinancing would not have been granted had the obligor not experienced difficulties in meeting its financial commitments.

(2) At least the following situations must be considered forbearance measures–

(a) new contract terms are more favourable to the obligor than the previous contract terms, where the obligor is experiencing or is likely to experience difficulties in meeting its financial commitments;

(b) new contract terms are more favourable to the obligor than contract terms offered by the same institution to obligors with a similar risk profile at that time, where the obligor is experiencing or is likely to experience difficulties in meeting its financial commitments;

(c) the exposure under the initial contract terms was classified as non-performing before the modification to the contract terms or would have been classified as non-performing in the absence of modification to the contract terms;

(d) the measure results in a total or partial cancellation of the debt obligation;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(e) the institution approves the exercise of clauses that enable the obligor to modify the terms of the contract and the exposure was classified as non-performing before the exercise of those clauses, or would be classified as non-performing were those clauses not exercised;

(f) at or close to the time of the granting of debt, the obligor made payments of principal or interest on another debt obligation with the same institution, which was classified as a non-performing exposure or would have been classified as non-performing in the absence of those payments;

(g) the modification to the contract terms involves repayments made by taking possession of collateral, where such modification constitutes a concession.

(3) The following circumstances are indicators that forbearance measures may have been adopted–

(a) the initial contract was past due by more than 30 days at least once during the three months prior to its modification or would be more than 30 days past due without modification;

(b) at or close to the time of concluding the credit agreement, the obligor made payments of principal or interest on another debt obligation with the same institution that was past due by 30 days at least once during the three months prior to the granting of new debt;

(c) the institution approves the exercise of clauses that enable the obligor to change the terms of the contract, and the exposure is 30 days past due or would be 30 days past due were those clauses not exercised.

(4) For the purposes of this Article, the difficulties experienced by an obligor in meeting its financial commitments must be assessed at obligor level, taking into account all the legal entities in the obligor's group which are included in the accounting consolidation of the group, and natural persons who control that group.

47C. [Not used]

Threshold exemptions from deduction from Common Equity Tier 1 items.

48.(1) In making the deductions required pursuant to Article 36(1)(c) and (i), institutions are not required to deduct the amounts of the items listed in sub-paragraphs (a) and (b) which in aggregate are equal to or less than the threshold amount referred to in paragraph (2)–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) deferred tax assets that are dependent on future profitability and arise from temporary differences, and in aggregate are equal to or less than 10% of the Common Equity Tier 1 items of the institution calculated after applying the following–

(i) Articles 32 to 35;

(ii) Article 36(1)(a) to (h), (k)(ii) to (iv) and (l), excluding deferred tax assets that rely on future profitability and arise from temporary differences;

(b) where an institution has a significant investment in a financial sector entity, the direct, indirect and synthetic holdings of that institution of the Common Equity Tier 1 instruments of those entities that in aggregate are equal to or less than 10% of the Common Equity Tier 1 items of the institution calculated after applying the following–

(i) Article 32 to 35;

(ii) Article 36(1) (a) to (h), (k)(ii) to (iv) and (l) excluding deferred tax assets that rely on future profitability and arise from temporary differences.

(2) For the purposes of paragraph (1), the threshold amount must be equal to the amount referred to in sub-paragraph (a) multiplied by the percentage referred to in sub-paragraph (b)–

(a) the residual amount of Common Equity Tier 1 items after applying the adjustments and deductions in Articles 32 to 36 in full and without applying the threshold exemptions specified in this Article;

(b) 17.65%.

(3) For the purposes of paragraph (1), an institution must determine the portion of deferred tax assets in the total amount of items that is not required to be deducted by dividing the amount specified in sub-paragraph (a) by the amount specified in sub-paragraph (b)–

(a) the amount of deferred tax assets that are dependent on future profitability and arise from temporary differences, and in aggregate are equal to or less than 10% of the Common Equity Tier 1 items of the institution;

(b) the sum of the following–

(i) the amount referred to in sub-paragraph (a);

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(ii) the amount of direct, indirect and synthetic holdings by the institution of the own funds instruments of financial sector entities in which the institution has a significant investment, and in aggregate are equal to or less than 10% of the Common Equity Tier 1 items of the institution.

The proportion of significant investments in the total amount of items that is not required to be deducted is equal to one minus the proportion referred to in the first sub-paragraph.

(4) The amounts of the items that are not deducted pursuant to paragraph (1) must be risk weighted at 250%.

Requirement for deduction where consolidation or supplementary supervision is applied.

49.(1) to (4) [Not used]

(5) Where an institution applies method 1, 2 or 3 in Schedule 1 to the Financial Services (Financial Conglomerates) Regulations 2020, the institution must disclose the supplementary own funds requirement and capital adequacy ratio of the financial conglomerate as calculated in accordance with those Regulations.

(6) [Not used]

Common Equity Tier 1 capital.

50. The Common Equity Tier 1 capital of an institution must consist of Common Equity Tier 1 items after the application of the adjustments required by Articles 32 to 35, the deductions required pursuant to Article 36 and the exemptions and alternatives laid down in Articles 48and 79.

CHAPTER 3
ADDITIONAL TIER 1 CAPITAL

Additional Tier 1 items and instruments

Additional Tier 1 items.

51. Additional Tier 1 items must consist of the following–

(a) capital instruments, where the conditions laid down in Article 52(1) are met;

(b) the share premium accounts related to the instruments referred to in sub-paragraph (a).

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Instruments included under sub-paragraph (a) must not qualify as Common Equity Tier 1 or Tier 2 items.

Additional Tier 1 instruments.

52. Capital instruments must qualify as Additional Tier 1 instruments only if the following conditions are met–

(a) the instruments are directly issued by an institution and fully paid up, and for this purpose only the part of a capital instrument that is fully paid up must be eligible to qualify as an Additional Tier 1 instrument;

(b) the instruments are not owned by any of the following–

(i) the institution or its subsidiaries;

(ii) an undertaking in which the institution has a participation in the form of ownership, direct or by way of control, of 20% or more of the voting rights or capital of that undertaking;

(c) the acquisition of ownership of the instruments is not funded directly or indirectly by the institution;

(d) the instruments rank below Tier 2 instruments in the event of the insolvency of the institution;

(e) the instruments are neither secured nor subject to a guarantee that enhances the seniority of the claims by any of the following–

(i) the institution or its subsidiaries;

(ii) the parent undertaking of the institution or its subsidiaries;

(iii) the parent financial holding company of the institution or its subsidiaries;

(iv) the mixed activity holding company of the institution or its subsidiaries;

(v) the mixed financial holding company of the institution or its subsidiaries;

(vi) any undertaking that has close links with entities referred to in paragraphs (i) to (v);

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(f) the instruments are not subject to any arrangement, contractual or otherwise, that enhances the seniority of the claim under the instruments in insolvency or liquidation;

(g) the instruments are perpetual and the provisions governing them include no incentive for the institution to redeem them;

(h) where the instruments include one or more early redemption options including call options, the options are exercisable at the sole discretion of the issuer;

(i) the instruments may be reduced, called, redeemed or repurchased only where the conditions laid down in Article 77 are met;

(j) the provisions governing the instruments do not indicate explicitly or implicitly that the instruments would be reduced, called, redeemed or repurchased, as applicable, by the institution other than early redemption options referred to in sub-paragraph (h) or in the case of the insolvency or liquidation of the institution and the institution does not otherwise provide such an indication;

(k) the institution does not indicate explicitly or implicitly that the GFSC would consent to a request to reduce, call, redeem or repurchase the instruments;

(l) distributions under the instruments meet the following conditions–

(i) they are paid out of distributable items;

(ii) the level of distributions made on the instruments will not be amended on the basis of the credit standing of the institution or its parent undertaking;

(iii) the provisions governing the instruments give the institution full discretion at all times to cancel the distributions on the instruments for an unlimited period and on a non-cumulative basis, and the institution may use such cancelled payments without restriction to meet its obligations as they fall due;

(iv) cancellation of distributions does not constitute an event of default of the institution;

(v) the cancellation of distributions imposes no restrictions on the institution;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(m) the instruments do not contribute to a determination that the liabilities of an institution exceed its assets, where such a determination constitutes a test of insolvency under the applicable law of Gibraltar or a third country;

(n) the provisions governing the instruments require that, upon the occurrence of a trigger event, the principal amount of the instruments be written down on a permanent or temporary basis or the instruments be converted to Common Equity Tier 1 instruments;

(o) the provisions governing the instruments include no feature that could hinder the recapitalisation of the institution;

(p) where the issuer is established in a third country and has been designated in accordance with regulation 12 of the Recovery and Resolution Regulations as part of a resolution group the resolution entity of which is established in Gibraltar or where the issuer is established in Gibraltar, the law or contractual provisions governing the instruments require that, upon a decision by the resolution authority to exercise the write-down and conversion powers referred to in regulation 59 of those Regulations , the principal amount of the instruments is to be written down on a permanent basis or the instruments are to be converted to Common Equity Tier 1 instruments;

where the issuer is established in a third country and has not been designated in accordance with regulation 12 of the Recovery and Resolution Regulations as part of a resolution group the resolution entity of which is established in Gibraltar, the law or contractual provisions governing the instruments require that, upon a decision by the relevant third-country authority, the principal amount of the instruments is to be written down on a permanent basis or the instruments are to be converted into Common Equity Tier 1 instruments;

(q) where the issuer is established in a third country and has been designated in accordance with regulation 12 of the Recovery and Resolution Regulations as part of a resolution group the resolution entity of which is established in Gibraltar or where the issuer is established in Gibraltar, the instruments may only be issued under, or be otherwise subject to the laws of a third country where, under those laws, the exercise of the write-down and conversion powers referred to in regulation 59 of those Regulations is effective and enforceable on the basis of statutory provisions or legally enforceable contractual provisions that recognise resolution or other write-down or conversion actions;

(r) the instruments are not subject to set-off or netting arrangements that would undermine their capacity to absorb losses.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Restrictions on the cancellation of distributions on Additional Tier 1 instruments and features that could hinder the recapitalisation of the institution.

53. For the purposes of Article 52(1)(l)(v) and (1)(o), the provisions governing Additional Tier 1 instruments must, in particular, not include the following–

(a) a requirement for distributions on the instruments to be made in the event of a distribution being made on an instrument issued by the institution that ranks to the same degree as, or more junior than, an Additional Tier 1 instrument, including a Common Equity Tier 1 instrument;

(b) a requirement for the payment of distributions on Common Equity Tier 1, Additional Tier 1 or Tier 2 instruments to be cancelled in the event that distributions are not made on those Additional Tier 1 instruments;

(c) an obligation to substitute the payment of interest or dividend by a payment in any other form. The institution must not otherwise be subject to such an obligation.

Write down or conversion of Additional Tier 1 instruments.

54.(1) For the purposes of Article 52(1)(n), the following provisions apply to Additional Tier 1 instruments–

(a) a trigger event occurs when the Common Equity Tier 1 capital ratio of the institution referred to in Article 92(1)(a) falls below either of the following–

(i) 5.125%;

(ii) a level higher than 5.125%, where determined by the institution and specified in the provisions governing the instrument;

(b) institutions may specify in the provisions governing the instrument one or more trigger events in addition to that referred to in sub-paragraph (a);

(c) where the provisions governing the instruments require them to be converted into Common Equity Tier 1 instruments upon the occurrence of a trigger event, those provisions must specify either of the following–

(i) the rate of such conversion and a limit on the permitted amount of conversion;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(ii) a range within which the instruments will convert into Common Equity Tier 1 instruments;

(d) where the provisions governing the instruments require their principal amount to be written down upon the occurrence of a trigger event, the write down must reduce all the following–

(i) the claim of the holder of the instrument in the insolvency or liquidation of the institution;

(ii) the amount required to be paid in the event of the call or redemption of the instrument;

(iii) the distributions made on the instrument;

(e) where the Additional Tier 1 instruments have been issued by a subsidiary undertaking established in a third country, the 5.125% or higher trigger referred to in sub-paragraph (a) must be calculated in accordance with the national law of that third country or contractual provisions governing the instruments, if those provisions are at least equivalent to the requirements set out in this Article.

(2) Write down or conversion of an Additional Tier 1 instrument must, under the applicable accounting framework, generate items that qualify as Common Equity Tier 1 items.

(3) The amount of Additional Tier 1 instruments recognised in Additional Tier 1 items is limited to the minimum amount of Common Equity Tier 1 items that would be generated if the principal amount of the Additional Tier 1 instruments were fully written down or converted into Common Equity Tier 1 instruments.

(4) The aggregate amount of Additional Tier 1 instruments that is required to be written down or converted upon the occurrence of a trigger event must be no less than the lower of the following–

(a) the amount required to restore fully the Common Equity Tier 1 ratio of the institution to 5.125%;

(b) the full principal amount of the instrument.

(5) When a trigger event occurs institutions must do the following–

(a) immediately inform the GFSC;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(b) inform the holders of the Additional Tier 1 instruments;

(c) write down the principal amount of the instruments, or convert the instruments into Common Equity Tier 1 instruments without delay, but no later than within one month, in accordance with the requirement laid down in this Article.

(6) An institution issuing Additional Tier 1 instruments that convert to Common Equity Tier 1 on the occurrence of a trigger event must ensure that its authorised share capital is at all times sufficient, for converting all such convertible Additional Tier 1 instruments into shares if a trigger event occurs. All necessary authorisations must be obtained at the date of issuance of such convertible Additional Tier 1 instruments. The institution must maintain at all times the necessary prior authorisation to issue the Common Equity Tier 1 instruments into which such Additional Tier 1 instruments would convert upon occurrence of a trigger event.

(7) An institution issuing Additional Tier 1 instruments that convert to Common Equity Tier 1 on the occurrence of a trigger event must ensure that there are no procedural impediments to that conversion by virtue of its incorporation or statutes or contractual arrangements.

Consequences of the conditions for Additional Tier 1 instruments ceasing to be met.

55. The following applies where, in the case of an Additional Tier 1 instrument, the conditions laid down in Article 52(1) cease to be met–

(a) that instrument must immediately cease to qualify as an Additional Tier 1 instrument;

(b) the part of the share premium accounts that relates to that instrument must immediately cease to qualify as an Additional Tier 1 item.

Deductions from Additional Tier 1 items

Deductions from Additional Tier 1 items.

56. Institutions must deduct the following from Additional Tier 1 items–

(a) direct, indirect and synthetic holdings by an institution of own Additional Tier 1 instruments, including own Additional Tier 1 instruments that an institution could be obliged to purchase as a result of existing contractual obligations;

(b) direct, indirect and synthetic holdings of the Additional Tier 1 instruments of financial sector entities where those entities have a reciprocal cross holding with

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

the institution that have been designed to inflate artificially the own funds of the institution;

(c) the applicable amount determined in accordance with Article 60 of direct, indirect and synthetic holdings of the Additional Tier 1 instruments of financial sector entities, where an institution does not have a significant investment in those entities;

(d) direct, indirect and synthetic holdings by the institution of the Additional Tier 1 instruments of financial sector entities where the institution has a significant investment in those entities, excluding underwriting positions held for five working days or fewer;

(e) the amount of items required to be deducted from Tier 2 items pursuant to Article 66 that exceeds the Tier 2 items of the institution;

(f) any tax charge relating to Additional Tier 1 items foreseeable at the moment of its calculation, except where the institution suitably adjusts the amount of Additional Tier 1 items so far as such tax charges reduce the amount up to which those items may be applied to cover risks or losses.

Deductions of holdings of own Additional Tier 1 instruments.

57. For the purposes of Article 56(a), institutions must calculate holdings of own Additional Tier 1 instruments on the basis of gross long positions subject to the following exceptions–

(a) institutions may calculate the amount of holdings of own Additional Tier 1 instruments on the basis of the net long position if both the following conditions are met–

(i) the long and short positions are in the same underlying exposure and the short positions involve no counterparty risk; and

(ii) either both the long and the short positions are held in the trading book or both are held in the non-trading book;

(b) institutions must determine the amount to be deducted for direct, indirect or synthetic holdings of index securities by calculating the underlying exposure to own Additional Tier 1 instruments in those indices;

(c) institutions may net gross long positions in own Additional Tier 1 instruments resulting from holdings of index securities against short positions in own

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Additional Tier 1 instruments resulting from short positions in the underlying indices, including where those short positions involve counterparty risk, if both the following conditions are met–

(i) the long and short positions are in the same underlying indices; and

(ii) either both the long and the short positions are held in the trading book or both are held in the non-trading book.

Deduction of holdings of Additional Tier 1 instruments of financial sector entities and where an institution has a reciprocal cross holding designed artificially to inflate own funds.

58. Institutions must make the deductions required by Article 56(b) to (d) in accordance with the following–

(a) holdings of Additional Tier 1 instruments must be calculated on the basis of the gross long positions;

(b) Additional Tier 1 own-fund insurance items must be treated as holdings of Additional Tier 1 instruments for the purposes of this deduction requirement.

Deduction of holdings of Additional Tier 1 instruments of financial sector entities.

59. Institutions must make the deductions required by Article 56(c) and (d) in accordance with the following–

(a) they may calculate direct, indirect and synthetic holdings of Additional Tier 1 instruments of the financial sector entities on the basis of the net long position in the same underlying exposure if both the following conditions are met–

(i) the maturity date of the short position is either the same as, or later than the maturity date of the long position or the residual maturity of the short position is at least one year;

(ii) either both the short position and the long position are held in the trading book or both are held in the non-trading book;

(b) they must determine the amount to be deducted for direct, indirect and synthetic holdings of index securities by calculating the underlying exposure to the capital instruments of the financial sector entities in those indices.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Deduction of holdings of Additional Tier 1 instruments where an institution does not have a significant investment in a financial sector entity.

60.(1) For the purposes of Article 56(c), institutions must calculate the applicable amount to be deducted by multiplying the amount referred to in sub-paragraph (a) by the factor derived from the calculation referred to in sub-paragraph (b)–

(a) the aggregate amount by which the direct, indirect and synthetic holdings by the institution of the Common Equity Tier 1, Additional Tier 1 and Tier 2 instruments of financial sector entities in which the institution does not have a significant investment exceeds 10% of the Common Equity Tier 1 items of the institution calculated after applying the following–

(i) Articles 32 to 35;

(ii) Article 36(a) to (g), (k)(ii) to (iv) and (l), excluding deferred tax assets that rely on future profitability and arise from temporary differences;

(iii) Articles 44 and 45;

(b) the amount of direct, indirect and synthetic holdings by the institution of the Additional Tier 1 instruments of those financial sector entities in which the institution does not have a significant investment divided by the aggregate amount of all direct, indirect and synthetic holdings by the institution of the Common Equity Tier 1, Additional Tier 1 and Tier 2 instruments of those financial sector entities.

(2) Institutions must exclude underwriting positions held for five working days or fewer from the amount referred to paragraph (1)(a) and from the calculation of the factor referred to in paragraph (1)(b).

(3) The amount to be deducted pursuant to paragraph (1) must be apportioned across all Additional Tier 1 instruments held. Institutions must determine the amount of each Additional Tier 1 instrument to be deducted pursuant to paragraph (1) by multiplying the amount specified in sub-paragraph (a) by the proportion specified in sub-paragraph (b)–

(a) the amount of holdings required to be deducted pursuant to paragraph (1);

(b) the proportion of the aggregate amount of direct, indirect and synthetic holdings by the institution of the Additional Tier 1 instruments of financial sector entities in which the institution does not have a significant investment represented by each Additional Tier 1 instrument held.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(4) The amount of holdings referred to in Article 56(c) that is equal to or less than 10% of the Common Equity Tier 1 items of the institution after applying the provisions laid down in paragraph (1)(a)(i) to (iii) must not be deducted and are subject to the applicable risk weights in accordance with Chapter 2 or 3 of Title 2 of Part 3 and the requirements laid down in Title 4 of Part 3, as applicable.

(5) Institutions must determine the amount of each Additional Tier 1 instrument that is risk weighted pursuant to paragraph (4) by multiplying the amount specified in sub-paragraph (a) by the amount specified in sub-paragraph (b)–

(a) the amount of holdings required to be risk weighted pursuant to paragraph (4);

(b) the proportion resulting from the calculation in paragraph (3)(b).

Additional Tier 1 capital

Additional Tier 1 capital.

61. The Additional Tier 1 capital of an institution must consist of Additional Tier 1 items after the deduction of the items referred to in Article 56 and the application of Article 79.

CHAPTER 4
TIER 2 CAPITAL

Tier 2 items and instruments

Tier 2 items.

62. Tier 2 items must consist of the following–

(a) capital instruments where the conditions set out in Article 63 are met, and to the extent specified in Article 64;

(b) the share premium accounts related to instruments referred to in sub-paragraph (a);

(c) for institutions calculating risk-weighted exposure amounts in accordance with Chapter 2 of Title 2 of Part 3, general credit risk adjustments, gross of tax effects, of up to 1.25% of risk-weighted exposure amounts calculated in accordance with Chapter 2 of Title 2 of Part 3;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(d) for institutions calculating risk-weighted exposure amounts under Chapter 3 of Title 2 of Part 3, positive amounts, gross of tax effects, resulting from the calculation laid down in Articles 158 and 159 up to 0.6% of risk-weighted exposure amounts calculated under Chapter 3 of Title 2 of Part 3.

Items included under sub-paragraph (a) must not qualify as Common Equity Tier 1 or Additional Tier 1 items.

Tier 2 instruments.

63. Capital instruments must qualify as Tier 2 instruments, if the following conditions are met–

(a) the instruments are directly issued by an institution and fully paid up;

(b) the instruments are not owned by any of the following–

(i) the institution or its subsidiaries;

(ii) an undertaking in which the institution has participation in the form of ownership, direct or by way of control, of 20% or more of the voting rights or capital of that undertaking;

(c) the acquisition of ownership of the instruments is not funded directly or indirectly by the institution;

(d) the claim on the principal amount of the instruments under the provisions governing the instruments ranks below any claim from eligible liabilities instruments;

(e) the instruments are not secured or are not subject to a guarantee that enhances the seniority of the claim by any of the following–

(i) the institution or its subsidiaries;

(ii) the parent undertaking of the institution or its subsidiaries;

(iii) the parent financial holding company of the institution or its subsidiaries;

(iv) the mixed activity holding company of the institution or its subsidiaries;

(v) the mixed financial holding company of the institution or its subsidiaries;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(vi) any undertaking that has close links with entities referred to in paragraphs (i) to (v);

(f) the instruments are not subject to any arrangement that otherwise enhances the seniority of the claim under the instruments;

(g) the instruments have an original maturity of at least five years;

(h) the provisions governing the instruments do not include any incentive for their principal amount to be redeemed or repaid, as applicable by the institution prior to their maturity;

(i) where the instruments include one or more early repayment options, including call options, the options are exercisable at the sole discretion of the issuer;

(j) the instruments may be called, redeemed, repaid or repurchased early only where the conditions set out in Article 77 are met;

(k) the provisions governing the instruments do not indicate explicitly or implicitly that the instruments would be reduced, called, redeemed, repaid or repurchased early, as applicable, by the institution other than in the case of the insolvency or liquidation of the institution and the institution does not otherwise provide such an indication;

(l) the provisions governing the instruments do not give the holder the right to accelerate the future scheduled payment of interest or principal, other than in the case of the insolvency or liquidation of the institution;

(m) the level of interest or dividends payments, as applicable, due on the instruments will not be amended on the basis of the credit standing of the institution or its parent undertaking;

(n) where the issuer is established in a third country and has been designated in accordance with regulation 12 of the Recovery and Resolution Regulations as part of a resolution group the resolution entity of which is established in Gibraltar or where the issuer is established in Gibraltar, the law or contractual provisions governing the instruments require that, upon a decision by the resolution authority to exercise the write-down and conversion powers referred to in regulation 59 of those Regulations , the principal amount of the instruments is to be written down on a permanent basis or the instruments are to be converted to Common Equity Tier 1 instruments;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

where the issuer is established in a third country and has not been designated in accordance with regulation 12 of the Recovery and Resolution Regulations as a part of a resolution group the resolution entity of which is established in Gibraltar, the law or contractual provisions governing the instruments require that, upon a decision by the relevant third-country authority, the principal amount of the instruments is to be written down on a permanent basis or the instruments are to be converted into Common Equity Tier 1 instruments;

(o) where the issuer is established in a third country and has been designated in accordance with regulation 12 of the Recovery and Resolution Regulations as part of a resolution group the resolution entity of which is established in Gibraltar or where the issuer is established in Gibraltar, the instruments may only be issued under, or be otherwise subject to the laws of a third country where, under those laws, the exercise of the write-down and conversion powers referred to in regulation 59 of those Regulations is effective and enforceable on the basis of statutory provisions or legally enforceable contractual provisions that recognise resolution or other write-down or conversion actions;

(p) the instruments are not subject to set-off or netting arrangements that would undermine their capacity to absorb losses.

Amortisation of Tier 2 instruments.

64.(1) The full amount of Tier 2 instruments with a residual maturity of more than five years must qualify as Tier 2 items.

(2) The extent to which Tier 2 instruments qualify as Tier 2 items during the final five years of maturity of the instruments is calculated by multiplying the result derived from the calculation referred to in sub-paragraph (a) by the amount referred to in sub-paragraph (b) as follows–

(a) the carrying amount of the instruments on the first day of the final five-year period of their contractual maturity divided by the number of days in that period;

(b) the number of remaining days of contractual maturity of the instruments.

Consequences of the conditions for Tier 2 instruments ceasing to be met.

65. Where in the case of a Tier 2 instrument the conditions laid down in Article 63 cease to be met, the following must apply–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) that instrument must immediately cease to qualify as a Tier 2 instrument;

(b) the part of the share premium accounts that relate to that instrument must immediately cease to qualify as Tier 2 items.

Deductions from Tier 2 items.

Deductions from Tier 2 items.

66. The following must be deducted from Tier 2 items–

(a) direct, indirect and synthetic holdings by an institution of own Tier 2 instruments, including own Tier 2 instruments that an institution could be obliged to purchase as a result of existing contractual obligations;

(b) direct, indirect and synthetic holdings of the Tier 2 instruments of financial sector entities where those entities have a reciprocal cross holding with the institution that have been designed to inflate artificially the own funds of the institution;

(c) the applicable amount determined in accordance with Article 70 of direct, indirect and synthetic holdings of the Tier 2 instruments of financial sector entities, where an institution does not have a significant investment in those entities;

(d) direct, indirect and synthetic holdings by the institution of the Tier 2 instruments of financial sector entities where the institution has a significant investment in those entities, excluding underwriting positions held for fewer than five working days;

(e) the amount of items to be deducted from eligible liabilities items that exceeds the eligible liabilities items of the institution.

Deductions of holdings of own Tier 2 instruments.

67. For the purposes of Article 66(a), institutions must calculate holdings on the basis of the gross long positions subject to the following exceptions–

(a) institutions may calculate the amount of holdings on the basis of the net long position if both the following conditions are met–

(i) the long and short positions are in the same underlying exposure and the short positions involve no counterparty risk;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(ii) either both the long and the short positions are held in the trading book or both are held in the non-trading book;

(b) institutions must determine the amount to be deducted for direct, indirect and synthetic holdings of index securities by calculating the underlying exposure to own Tier 2 instruments in those indices;

(c) institutions may net gross long positions in own Tier 2 instruments resulting from holdings of index securities against short positions in own Tier 2 instruments resulting from short positions in the underlying indices, including where those short positions involve counterparty risk, if both the following conditions are met–

(i) the long and short positions are in the same underlying indices;

(ii) either both the long and the short positions are held in the trading book or both are held in the non-trading book.

Deduction of holdings of Tier 2 instruments of financial sector entities and where an institution has a reciprocal cross holding designed artificially to inflate own funds.

68. Institutions must make the deductions required by Article 66(b) to (d) in accordance with the following provisions–

(a) holdings of Tier 2 instruments must be calculated on the basis of the gross long positions;

(b) holdings of Tier 2 own-fund insurance items and Tier 3 own-fund insurance items must be treated as holdings of Tier 2 instruments for the purposes of this deduction requirement.

Deduction of holdings of Tier 2 instruments of financial sector entities.

69. Institutions must make the deductions required by Article 66(c) and (d) in accordance with the following–

(a) they may calculate direct, indirect and synthetic holdings of Tier 2 instruments of the financial sector entities on the basis of the net long position in the same underlying exposure if both the following conditions are met–

(i) the maturity date of the short position is either the same as, or later than the maturity date of the long position or the residual maturity of the short position is at least one year;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(ii) either both the long position and the short position are held in the trading book or both are held in the non-trading book;

(b) they must determine the amount to be deducted for direct, indirect and synthetic holdings of index securities by looking through to the underlying exposure to the capital instruments of the financial sector entities in those indices.

Deduction of Tier 2 instruments where an institution does not have a significant investment in a relevant entity.

70.(1) For the purposes of Article 66(c), institutions must calculate the applicable amount to be deducted by multiplying the amount referred to in sub-paragraph (a) by the factor derived from the calculation referred to in sub-paragraph (b)–

(a) the aggregate amount by which the direct, indirect and synthetic holdings by the institution of the Common Equity Tier 1, Additional Tier 1 and Tier 2 instruments of financial sector entities in which the institution does not have a significant investment exceeds 10% of the Common Equity Tier 1 items of the institution calculated after applying the following–

(i) Articles 32 to 35;

(ii) Article 36(1)(a) to (g), (k)(ii) to (iv) and (l), excluding the amount to be deducted for deferred tax assets that rely on future profitability and arise from temporary differences;

(iii) Articles 44 and 45;

(b) the amount of direct, indirect and synthetic holdings by the institution of the Tier 2 instruments of financial sector entities in which the institution does not have a significant investment divided by the aggregate amount of all direct, indirect and synthetic holdings by the institution of the Common Equity Tier 1, Additional Tier 1 and Tier 2 instruments of those financial sector entities.

(2) Institutions must exclude underwriting positions held for five working days or fewer from the amount referred to in paragraph (1)(a) and from the calculation of the factor referred to in paragraph (1)(b).

(3) The amount to be deducted pursuant to paragraph (1) must be apportioned across each Tier 2 instrument held. Institutions must determine the amount to be deducted from each Tier

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

2 instrument that is deducted pursuant to paragraph (1) by multiplying the amount specified in sub-paragraph (a) by the proportion specified in sub-paragraph (b)–

(a) the total amount of holdings required to be deducted pursuant to paragraph (1);

(b) the proportion of the aggregate amount of direct, indirect and synthetic holdings by the institution of the Tier 2 instruments of financial sector entities in which the institution does not have a significant investment represented by each Tier 2 instrument held.

(4) The amount of holdings referred to in Article 66(c) that is equal to or less than 10% of the Common Equity Tier 1 items of the institution after applying the provisions laid down in paragraph (1)(a)(i) to (iii) must not be deducted and are subject to the applicable risk weights in accordance with Chapter 2 or 3 of Title 2 of Part 3 and the requirements laid down in Title 4 of Part 3, as applicable.

(5) Institutions must determine the amount of each Tier 2 instrument that is risk weighted pursuant to paragraph (4) by multiplying the amount specified in sub-paragraph (a) by the amount specified in sub-paragraph (b)–

(a) the amount of holdings required to be risk weighted pursuant to paragraph (4);

(b) the proportion resulting from the calculation in paragraph (3)(b).

Tier 2 capital

Tier 2 capital.

71. The Tier 2 capital of an institution must consist of the Tier 2 items of the institution after the deductions referred to in Article 66 and the application of Article 79.

CHAPTER 5
OWN FUNDS

Own funds.

72. The own funds of an institution must consist of the sum of its Tier 1 capital and Tier 2 capital.

CHAPTER 5A
ELIGIBLE LIABILITIES

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Deductions from eligible liabilities items

Eligible liabilities items.

72A.(1) Eligible liabilities items must consist of the following, unless they fall into any of the categories of excluded liabilities laid down in paragraph (2), and to the extent specified in Article 72C–

(a) eligible liabilities instruments where the conditions set out in Article 72B are met, to the extent that they do not qualify as Common Equity Tier 1, Additional Tier 1 or Tier 2 items;

(b) Tier 2 instruments with a residual maturity of at least one year, to the extent that they do not qualify as Tier 2 items in accordance with Article 64.

(2) The following liabilities must be excluded from eligible liabilities items–

(a) covered deposits;

(b) sight deposits and short term deposits with an original maturity of less than one year;

(c) the part of eligible deposits from natural persons and micro, small and medium-sized enterprises which exceeds the coverage level referred to section 214 of the Act;

(d) deposits that would be eligible deposits from natural persons, micro, small and medium–sized enterprises if they were not made through branches located outside Gibraltar of institutions established in Gibraltar;

(e) secured liabilities, including covered bonds and liabilities in the form of financial instruments used for hedging purposes that form an integral part of the cover pool and that in accordance with the law of Gibraltar are secured in a manner similar to covered bonds, if all secured assets relating to a covered bond cover pool remain unaffected, segregated and with enough funding and excluding any part of a secured liability or a liability for which collateral has been pledged that exceeds the value of the assets, pledge, lien or collateral against which it is secured;

(f) any liability that arises by virtue of the holding of client assets or client money including client assets or client money held on behalf of collective investment undertakings, if such a client is protected under the applicable insolvency law;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(g) any liability that arises by virtue of a fiduciary relationship between the resolution entity or any of its subsidiaries (as fiduciary) and another person (as beneficiary), if such a beneficiary is protected under the applicable insolvency or civil law;

(h) liabilities to institutions, excluding liabilities to entities that are part of the same group, with an original maturity of less than seven days;

(i) liabilities with a remaining maturity of less than seven days, owed to–

(i) systems or system operators designated in accordance with regulation 5 of the Financial Services (Financial Markets and Insolvency: Settlement Finality) Regulations 2020;

(ii) participants, as defined in regulation 2(1) of the Financial Services (Financial Markets and Insolvency: Settlement Finality) Regulations 2020, in a system designated in accordance with regulation 5 of those Regulations and arising from the participation in such a system; or

(iii) third-country CCPs recognised in accordance with Article 25 of EMIR;

(j) a liability to any of the following–

(i) an employee in relation to accrued salary, pension benefits or other fixed remuneration, except for the variable component of the remuneration that is not regulated by a collective bargaining agreement, and except for the variable component of the remuneration of material risk takers within the scope of regulation 49(1) of the CICR Regulations;

(ii) a commercial or trade creditor where the liability arises from the provision to the institution or the parent undertaking of goods or services that are critical to the daily functioning of the institution's or parent undertaking's operations, including IT services, utilities and the rental, servicing and upkeep of premises;

(iii) tax and social security authorities, if those liabilities are preferred under the applicable law;

(iv) deposit guarantee schemes where the liability arises from contributions due in accordance with Chapter 3 of Part 15 of the Act;

(k) liabilities arising from derivatives;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(l) liabilities arising from debt instruments with embedded derivatives.

For the purposes of sub-paragraph (l), debt instruments containing early redemption options exercisable at the discretion of the issuer or of the holder, and debt instruments with variable interests derived from a broadly used reference rate such as Euribor or Libor, must not be considered as debt instruments with embedded derivatives solely because of such features.

Eligible liabilities instruments.

72B.(1) Liabilities qualify as eligible liabilities instruments if they comply with the conditions set out in this Article and only to the extent specified in this Article.

(2) Liabilities qualify as eligible liabilities instruments if all the following conditions are met–

(a) the liabilities are directly issued or raised, as applicable, by an institution and are fully paid up;

(b) the liabilities are not owned by any of the following–

(i) the institution or an entity included in the same resolution group;

(ii) an undertaking in which the institution has a direct or indirect participation in the form of ownership, direct or by way of control, of 20% or more of the voting rights or capital of that undertaking;

(c) the acquisition of ownership of the liabilities is not funded directly or indirectly by the resolution entity;

(d) the claim on the principal amount of the liabilities under the provisions governing the instruments is wholly subordinated to claims arising from the excluded liabilities referred to in Article 72A(2); that subordination requirement must be considered to be met in any of the following situations–

(i) the contractual provisions governing the liabilities specify that in the event of normal insolvency proceedings as defined in regulation 3(1) of the Recovery and Resolution Regulations, the claim on the principal amount of the instruments ranks below claims arising from any of the excluded liabilities referred to in Article 72A(2);

(ii) the applicable law specifies that in the event of normal insolvency proceedings as defined in regulation 3(1) of the Recovery and Resolution

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Regulations, the claim on the principal amount of the instruments ranks below claims arising from any of the excluded liabilities referred to in Article 72A(2);

(iii) the instruments are issued by a resolution entity which does not have on its balance sheet any excluded liabilities as referred to in Article 72A(2) that rank *pari passu* or junior to eligible liabilities instruments;

(e) the liabilities are neither secured, nor subject to a guarantee or any other arrangement that enhances the seniority of the claim by any of the following–

(i) the institution or its subsidiaries;

(ii) the parent undertaking of the institution or its subsidiaries;

(iii) any undertaking that has close links with entities referred to in paragraphs (i) and (ii);

(f) the liabilities are not subject to set-off or netting arrangements that would undermine their capacity to absorb losses in resolution;

(g) the provisions governing the liabilities do not include any incentive for their principal amount to be called, redeemed or repurchased prior to their maturity or repaid early by the institution, as applicable, except in the cases referred to in Article 72C(3);

(h) the liabilities are not redeemable by the holders of the instruments prior to their maturity, except in the cases referred to in Article 72C(2);

(i) subject to Article 72C(3) and (4), where the liabilities include one or more early repayment options, including call options, the options are exercisable at the sole discretion of the issuer, except in the cases referred to in Article 72C(2);

(j) the liabilities may only be called, redeemed, repaid or repurchased early where the conditions set out in Articles 77 and 78A are met;

(k) the provisions governing the liabilities do not indicate explicitly or implicitly that the liabilities would be called, redeemed, repaid or repurchased early, as applicable by the resolution entity other than in the case of the insolvency or liquidation of the institution and the institution does not otherwise provide such an indication;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(l) the provisions governing the liabilities do not give the holder the right to accelerate the future scheduled payment of interest or principal, other than in the case of the insolvency or liquidation of the resolution entity;

(m) the level of interest or dividend payments, as applicable, due on the liabilities is not amended on the basis of the credit standing of the resolution entity or its parent undertaking;

(n) for instruments issued after 28 June 2021 the relevant contractual documentation and, where applicable, the prospectus related to the issuance explicitly refer to the possible exercise of the write-down and conversion powers in accordance with regulation 48 of the Recovery and Resolution Regulations.

For the purposes of sub-paragraph (a), only the parts of liabilities that are fully paid up are eligible to qualify as eligible liabilities instruments.

For the purposes of sub-paragraph (d), where some of the excluded liabilities referred to in Article 72A(2) are subordinated to ordinary unsecured claims under national insolvency law, inter alia, due to being held by a creditor who has close links with the debtor, by being or having been a shareholder, in a control or group relationship, a member of the management body or related to any of those persons, subordination must not be assessed by reference to claims arising from such excluded liabilities.

(3) In addition to the liabilities referred to in paragraph (2), the resolution authority may permit liabilities to qualify as eligible liabilities instruments up to an aggregate amount that does not exceed 3.5% of the total risk exposure amount calculated in accordance with Article 92(3) and (4), if–

(a) all the conditions set out in paragraph (2) except for the condition set out in the first sub-paragraph of paragraph (2)(d) are met;

(b) the liabilities rank *pari passu* with the lowest ranking excluded liabilities referred to in Article 72A(2) with the exception of the excluded liabilities that are subordinated to ordinary unsecured claims under Gibraltar insolvency law referred to in the third sub-paragraph of paragraph (2); and

(c) the inclusion of those liabilities in eligible liabilities items would not give rise to a material risk of a successful legal challenge or of valid compensation claims as assessed by the resolution authority in relation to the principles set out in regulations 34(1)(g) and 75 of the Recovery and Resolution Regulations.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(4) The resolution authority may permit liabilities to qualify as eligible liabilities instruments in addition to the liabilities referred to in paragraph (2), if–

(a) the institution is not permitted to include in eligible liabilities items liabilities referred to in paragraph (3);

(b) all the conditions set out in paragraph (2), except for the condition set out in paragraph (2)(d), are met;

(c) the liabilities rank *pari passu* or are senior to the lowest ranking excluded liabilities referred to in Article 72A(2), with the exception of the excluded liabilities subordinated to ordinary unsecured claims under Gibraltar insolvency law referred to in the third sub-paragraph of paragraph (2);

(d) on the balance sheet of the institution, the amount of the excluded liabilities referred to in Article 72A(2) which rank *pari passu* or below those liabilities in insolvency does not exceed 5% of the amount of the own funds and eligible liabilities of the institution;

(e) the inclusion of those liabilities in eligible liabilities items would not give rise to a material risk of a successful legal challenge or of valid compensation claims as assessed by the resolution authority in relation to the principles set out in regulations 34(1)(g) and 75 of the Recovery and Resolution Regulations.

(5) The resolution authority may only permit an institution to include liabilities referred to either in paragraph (3) or (4) as eligible liabilities items.

(6) The resolution authority must consult the GFSC when examining whether the conditions set out in this Article are fulfilled.

(7) [Not used]

Amortisation of eligible liabilities instruments.

72C.(1) Eligible liabilities instruments with a residual maturity of at least one year fully qualify as eligible liabilities items.

Eligible liabilities instruments with a residual maturity of less than one year do not qualify as eligible liabilities items.

(2) For the purposes of paragraph (1), where a eligible liabilities instrument includes a holder redemption option exercisable prior to the original stated maturity of the instrument, the

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

maturity of the instrument must be defined as the earliest possible date on which the holder can exercise the redemption option and request redemption or repayment of the instrument.

(3) For the purposes of paragraph (1), where an eligible liabilities instrument includes an incentive for the issuer to call, redeem, repay or repurchase the instrument prior to the original stated maturity of the instrument, the maturity of the instrument must be defined as the earliest possible date on which the issuer can exercise that option and request redemption or repayment of the instrument.

(4) For the purposes of paragraph (1), where an eligible liabilities instrument includes early redemption options that are exercisable at the sole discretion of the issuer prior to the original stated maturity of the instrument, but where the provisions governing the instrument do not include any incentive for the instrument to be called, redeemed, repaid or repurchased prior to its maturity and do not include any option for redemption or repayment at the discretion of the holders, the maturity of the instrument must be defined as the original stated maturity.

Consequences of the eligibility conditions ceasing to be met.

72D. Where, in the case of an eligible liabilities instrument, the applicable conditions set out in Article 72B cease to be met, the liabilities must immediately cease to qualify as eligible liabilities instruments.

Liabilities referred to in Article 72B(2) may continue to count as eligible liabilities instruments as long as they qualify as eligible liabilities instruments under Article 72B(3) or (4).

Deductions from eligible liabilities items

Deductions from eligible liabilities items.

72E.(1) Institutions that are subject to Article 92A must deduct the following from eligible liabilities items–

(a) direct, indirect and synthetic holdings by the institution of own eligible liabilities instruments, including own liabilities that that institution could be obliged to purchase as a result of existing contractual obligations;

(b) direct, indirect and synthetic holdings by the institution of eligible liabilities instruments of G-SII entities with which the institution has reciprocal cross holdings that the competent authority considers to have been designed to artificially inflate the loss absorption and recapitalisation capacity of the resolution entity;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(c) the applicable amount determined in accordance with Article 72I of direct, indirect and synthetic holdings of eligible liabilities instruments of G-SII entities, where the institution does not have a significant investment in those entities;

(d) direct, indirect and synthetic holdings by the institution of eligible liabilities instruments of G-SII entities, where the institution has a significant investment in those entities, excluding underwriting positions held for five business days or fewer.

(2) For the purposes of Articles 72E to 72J, all instruments ranking *pari passu* with eligible liabilities instruments must be treated as eligible liabilities instruments, with the exception of instruments ranking *pari passu* with instruments recognised as eligible liabilities pursuant to Article 72B(3) and (4).

(3) For the purposes of Articles 72E to 72J, institutions may calculate the amount of holdings of the eligible liabilities instruments referred to in Article 72B(3) as follows–

$$h = \sum_i \left(H_i \times \frac{l_i}{L_i} \right)$$

Where–

h = the amount of holdings of the eligible liabilities instruments referred to in Article 72B(3);

i = the index denoting the issuing institution;

H i = the total amount of holdings of eligible liabilities of the issuing institution i referred to in Article 72B(3);

l i = the amount of liabilities included in eligible liabilities items by the issuing institution i within the limits specified in Article 72B(3) according to the latest disclosures by the issuing institution; and

L i = the total amount of the outstanding liabilities of the issuing institution i referred to in Article 72B(3) according to the latest disclosures by the issuer.

(4) Where a Gibraltar parent institution or a parent institution in Gibraltar that is subject to Article 92A has direct, indirect or synthetic holdings of own funds instruments or eligible

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

liabilities instruments of one or more subsidiaries which do not belong to the same resolution group as that parent institution, the resolution authority after duly considering the opinion of any relevant third country resolution authority, may permit the parent institution to deduct such holdings by deducting a lower amount specified by the resolution authority of that parent institution. That adjusted amount must be at least equal to the amount (m) calculated as follows–

$$m_i = \max\{0; OP_i + LP_i - \max\{0; \beta \cdot [O_i + L_i - r_i \cdot aRWA_i]\}\}$$

where–

i = the index denoting the subsidiary;

OP_i = the amount of own funds instruments issued by subsidiary i and held by the parent institution;

LP_i = the amount of eligible liabilities items issued by subsidiary i and held by the parent institution;

β = percentage of own funds instruments and eligible liabilities items issued by subsidiary i and held by the parent undertaking;

O_i = the amount of own funds of subsidiary i, not taking into account the deduction calculated in accordance with this paragraph;

L_i = the amount of eligible liabilities of subsidiary i, not taking into account the deduction calculated in accordance with this paragraph;

r_i = the ratio applicable to subsidiary i at the level of its resolution group in accordance with Article 92A(1)(a) and regulation 45D of the Recovery and Resolution Regulations; and

$aRWA_i$ = the total risk exposure amount of the G-SII entity i calculated in accordance with Article 92(3) and (4), taking into account the adjustments set out in Article 12A.

Where the parent institution is allowed to deduct the adjusted amount in accordance with the first sub-paragraph, the difference between the amount of holdings of own funds instruments and eligible liabilities instruments referred to in the first sub-paragraph and that adjusted amount must be deducted by the subsidiary.

Deduction of holdings of own eligible liabilities instruments.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

72F. For the purposes of Article 72E(1)(a), institutions must calculate holdings on the basis of the gross long positions subject to the following exceptions–

(a) institutions may calculate the amount of holdings on the basis of the net long position if both the following conditions are met–

(i) the long and short positions are in the same underlying exposure and the short positions involve no counterparty risk;

(ii) either both the long and the short positions are held in the trading book or both are held in the non-trading book;

(b) institutions must determine the amount to be deducted for direct, indirect and synthetic holdings of index securities by calculating the underlying exposure to own eligible liabilities instruments in those indices;

(c) institutions may net gross long positions in own eligible liabilities instruments resulting from holdings of index securities against short positions in own eligible liabilities instruments resulting from short positions in underlying indices, including where those short positions involve counterparty risk, if both the following conditions are met–

(i) the long and short positions are in the same underlying indices;

(ii) either both the long and the short positions are held in the trading book or both are held in the non-trading book.

Deduction base for eligible liabilities items.

72G. For the purposes of Article 72E(1)(b) to (d), institutions must deduct the gross long positions subject to the exceptions laid down in Articles 72H and 72I.

Deduction of holdings of eligible liabilities of other G-SII entities.

72H. Institutions not making use of the exception set out in Article 72J must make the deductions referred to in Article 72E(1)(c) and (d) in accordance with the following–

(a) they may calculate direct, indirect and synthetic holdings of eligible liabilities instruments on the basis of the net long position in the same underlying exposure, if both the following conditions are met–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(i) the maturity date of the short position is either the same as, or later than the maturity date of the long position or the residual maturity of the short position is at least one year;

(ii) either both the long position and the short position are held in the trading book or both are held in the non-trading book;

(b) they must determine the amount to be deducted for direct, indirect and synthetic holdings of index securities by looking through to the underlying exposure to the eligible liabilities instruments in those indices.

Deduction of eligible liabilities where the institution does not have a significant investment in G-SII entities.

72I.(1) For the purposes of Article 72E(1)(c), institutions must calculate the applicable amount to be deducted by multiplying the amount referred to in sub-paragraph (a) by the factor derived from the calculation referred to in sub-paragraph (b)–

(a) the aggregate amount by which the direct, indirect and synthetic holdings by the institution of the Common Equity Tier 1, Additional Tier 1, Tier 2 instruments of financial sector entities and eligible liabilities instruments of G-SII entities in none of which the institution has a significant investment exceeds 10% of the Common Equity Tier 1 items of the institution after applying the following–

(i) Articles 32 to 35;

(ii) Article 36(1)(a) to (g), (k)(ii) to (k)(v) and (l), excluding the amount to be deducted for deferred tax assets that rely on future profitability and arise from temporary differences;

(iii) Articles 44 and 45;

(b) the amount of direct, indirect and synthetic holdings by the institution of the eligible liabilities instruments of G-SII entities in which the institution does not have a significant investment divided by the aggregate amount of the direct, indirect and synthetic holdings by the institution of the Common Equity Tier 1, Additional Tier 1, Tier 2 instruments of financial sector entities and eligible liabilities instruments of G-SII entities in none of which the resolution entity has a significant investment.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(2) Institutions must exclude underwriting positions held for five business days or fewer from the amounts referred to in paragraph (1)(a) and from the calculation of the factor in accordance with paragraph (1)(b).

(3) The amount to be deducted pursuant to paragraph (1) must be apportioned across each eligible liabilities instrument of a G-SII entity held by the institution. Institutions must determine the amount of each eligible liabilities instrument that is deducted pursuant to paragraph (1) by multiplying the amount specified in sub-paragraph (a) by the proportion specified in sub-paragraph (b)–

(a) the amount of holdings required to be deducted pursuant to paragraph (1);

(b) the proportion of the aggregate amount of direct, indirect and synthetic holdings by the institution of the eligible liabilities instruments of G-SII entities in which the institution does not have a significant investment represented by each eligible liabilities instrument held by the institution.

(4) The amount of holdings referred to in Article 72E(1)(c) that is equal to or less than 10% of the Common Equity Tier 1 items of the institution after applying the provisions laid down in paragraph(1)(a)(i), (a)(ii) and (a)(iii) must not be deducted and are subject to the applicable risk weights in accordance with Chapter 2 or 3 of Title 2 of Part 3 and the requirements laid down in Title 4 of Part 3, as applicable.

(5) Institutions must determine the amount of each eligible liabilities instrument that is risk weighted pursuant to paragraph (4) by multiplying the amount of holdings required to be risk weighted pursuant to paragraph (4) by the proportion resulting from the calculation specified in paragraph (3)(b).

Trading book exception from deductions from eligible liabilities items.

72J.(1) Institutions may decide not to deduct a designated part of their direct, indirect and synthetic holdings of eligible liabilities instruments, that in aggregate and measured on a gross long basis is equal to or less than 5% of the Common Equity Tier 1 items of the institution after applying Articles 32 to 36, if all the following conditions are met–

(a) the holdings are in the trading book;

(b) the eligible liabilities instruments are held for no longer than 30 business days.

(2) The amounts of the items that are not deducted pursuant to paragraph (1) must be subject to own funds requirements for items in the trading book.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(3) Where, in the case of holdings not deducted in accordance with paragraph (1), the conditions set out in that paragraph cease to be met, the holdings must be deducted in accordance with Article 72G without applying the exceptions laid down in Articles 72H and 72I.

Own funds and eligible liabilities

Eligible liabilities.

72K. The eligible liabilities of an institution must consist of the eligible liabilities items of the institution after the deductions referred to in Article 72E.

Own funds and eligible liabilities.

72L. The own funds and eligible liabilities of an institution must consist of the sum of its own funds and its eligible liabilities.

CHAPTER 6
GENERAL REQUIREMENTS FOR OWN FUNDS AND ELIGIBLE LIABILITIES

Distributions on instruments.

73.(1) Capital instruments and liabilities for which an institution has the sole discretion to decide to pay distributions in a form other than cash or own funds instruments are not eligible to qualify as Common Equity Tier 1, Additional Tier 1, Tier 2 instruments, unless the institution has received GFSC Art.5A(4) approval.

(2) The GFSC, when determining an application under paragraph (1), must consider whether all of the following conditions are met–

(a) the ability of the institution to cancel payments under the instrument would not be adversely affected by the discretion referred to in paragraph (1), or by the form in which distributions could be made;

(b) the ability of the capital instrument or of the liability to absorb losses would not be adversely affected by the discretion referred to in paragraph (1), or by the form in which distributions could be made;

(c) the quality of the capital instrument or liability would not otherwise be reduced by the discretion referred to in paragraph (1), or by the form in which distributions could be made.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

The GFSC must consult the resolution authority regarding an institution's compliance with those conditions before granting the approval referred to in paragraph (1).

(3) Capital instruments and liabilities for which a legal person other than the institution issuing them has the discretion to decide or require that the payment of distributions on those instruments or liabilities must be made in a form other than cash or own funds instruments must not be eligible to qualify as Common Equity Tier 1, Additional Tier 1 or Tier 2 instruments.

(4) Institutions may use a broad market index as one of the bases for determining the level of distributions on Additional Tier 1 and Tier 2 instruments.

(5) Paragraph (4) must not apply where the institution is a reference entity in that broad market index unless both the following conditions are met–

(a) the institution considers movements in that broad market index not to be significantly correlated to the credit standing of the institution, its parent institution or parent financial holding company or parent mixed financial holding company or parent mixed activity holding company;

(b) the GFSC has not reached a different determination from that referred to in sub-paragraph (a).

(6) Institutions must report and disclose the broad market indices on which their capital instruments rely.

(7) [Not used]

Holdings of capital instruments issued by regulated financial sector entities that do not qualify as regulatory capital.

74. Institutions must not deduct from any element of own funds direct, indirect or synthetic holdings of capital instruments issued by a regulated financial sector entity that do not qualify as regulatory capital of that entity. Institutions must apply risk weights to such holdings in accordance with Chapter 2 or 3 of Title 2 of Part 3, as applicable.

Deduction and maturity requirements for short positions.

75. The maturity requirements for short positions referred to in Article 45(a), Article 59(a) and Article 69(a) must be considered to be met in respect of positions held where all the following conditions are met–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) the institution has the contractual right to sell on a specific future date to the counterparty providing the hedge the long position that is being hedged;

(b) the counterparty providing the hedge to the institution is contractually obliged to purchase from the institution on that specific future date the long position referred to in sub-paragraph (a).

Index holdings of capital instruments.

76.(1) For the purposes of Article 42(a), Article 45(a), Article 57(a), Article 59(a), Article 67(a) and Article 69(a), institutions may reduce the amount of a long position in a capital instrument by the portion of an index that is made up of the same underlying exposure that is being hedged, if all the following conditions are met–

(a) either both the long position being hedged and the short position in an index used to hedge that long position are held in the trading book or both are held in the non-trading book;

(b) the positions referred to in sub-paragraph (a) are held at fair value on the balance sheet of the institution;

(c) the short position referred to in sub-paragraph (a) qualifies as an effective hedge under the internal control processes of the institution;

(d) the internal control processes referred to in sub-paragraph (c) are adequate.

(2) An institution must not use a conservative estimate of the underlying exposure of the institution to instruments included in indices as an alternative to an institution calculating its exposure to the items referred to in one or more of the following–

(a) own Common Equity Tier 1, Additional Tier 1and Tier 2 instruments included in indices;

(b) Common Equity Tier 1, Additional Tier 1 and Tier 2 instruments of financial sector entities, included in indices;

unless the institution has GFSC Art.5A(4) approval.

(3) The GFSC, in determining an application under paragraph (2), must consider whether the institution has demonstrated to its satisfaction that it would be operationally burdensome for the institution to monitor its underlying exposure to the items referred to in paragraph (2), as applicable.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(4) [Not used]

Conditions for reducing own funds and eligible liabilities.

77.(1) An institution must not–

(a) reduce, redeem or repurchase Common Equity Tier 1 instruments issued by the institution; or

(b) reduce, distribute or reclassify as another own funds item the share premium accounts related to own funds instruments;

without GFSC Art.5A(4) approval.

(2) The requirement in paragraph (1) does not apply where own funds instruments–

(a) reach contractual maturity; or

(b) are converted or cancelled under their contractual terms.

Supervisory approval to reduce own funds.

78.(1) The GFSC, in determining an application under Article 77, must consider whether either of the following conditions is met–

(a) before or at the same time as any of the actions referred to in Article 77(1), the institution replaces the instruments or the related share premium accounts referred to in Article 77(1) with own funds instruments of equal or higher quality at terms that are sustainable for the income capacity of the institution;

(b) the institution has demonstrated to the satisfaction of the GFSC that the own funds and eligible liabilities of the institution would, following the action referred to in Article 77(1), exceed the requirements laid down in these Standards and in the CICR Regulations and the Recovery and Resolution Regulations by a margin that the GFSC considers necessary.

Where an institution provides sufficient safeguards as to its capacity to operate with own funds above the amounts required in these Standards and in the CICR Regulations, the GFSC may grant that institution a general approval to take any of the actions set out in Article 77(1), subject to criteria that ensure that any such future action will be in accordance with the conditions set out in sub-paragraphs (a) and (b).

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

That general approval must be granted only for a specified period, which must not exceed one year, after which it may be renewed. The general approval must be granted for a certain predetermined amount, set by the GFSC.

In the case of Common Equity Tier 1 instruments, that predetermined amount must not exceed 3% of the relevant issue and must not exceed 10% of the amount by which Common Equity Tier 1 capital exceeds the sum of the Common Equity Tier 1 capital requirements laid down in these Standards, in the CICR Regulations and the Recovery and Resolution Regulations by a margin that the GFSC considers necessary.

In the case of Additional Tier 1 or Tier 2 instruments, that predetermined amount must not exceed 10% of the relevant issue and must not exceed 3% of the total amount of outstanding Additional Tier 1 or Tier 2 instruments, as applicable.

The GFSC must withdraw the general approval where an institution breaches any of the criteria provided for the purposes of that approval.

(2) When assessing the sustainability of the replacement instruments for the income capacity of the institution referred to in paragraph (1)(a), the GFSC must consider the extent to which those replacement capital instruments would be more costly for the institution than those capital instruments or share premium accounts they would replace.

(3) Where an institution takes an action referred to in Article 77(1)(a) and the refusal of redemption of Common Equity Tier 1 instruments referred to in Article 27 is prohibited by the applicable law of Gibraltar or a third country, the GFSC may waive the conditions set out in paragraph (1), where the GFSC requires the institution to limit the redemption of such instruments on an appropriate basis.

(4) The GFSC may permit institutions to call, redeem, repay or repurchase Additional Tier 1 or Tier 2 instruments or related share premium accounts during the five years following their date of issuance where the conditions set out in paragraph (1) and one of the following conditions is met–

(a) there is a change in the regulatory classification of those instruments that would be likely to result in their exclusion from own funds or reclassification as own funds of lower quality, and both the following conditions are met–

(i) the GFSC considers such a change to be sufficiently certain;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(ii) the institution demonstrates to the satisfaction of the GFSC that the regulatory reclassification of those instruments was not reasonably foreseeable at the time of their issuance;

(b) there is a change in the applicable tax treatment of those instruments which the institution demonstrates to the satisfaction of the GFSC is material and was not reasonably foreseeable at the time of their issuance;

(c) the instruments and related share premium accounts were grandfathered under Article 494B(3) of Regulation (EU) 575/2013 as it applied before 1st February 2026;

(d) before or at the same time as the action referred to in Article 77(1), the institution replaces the instruments or related share premium accounts referred to in Article 77(1) with own funds instruments of equal or higher quality at terms that are sustainable for the income capacity of the institution and the GFSC has permitted that action on the basis of the determination that it would be beneficial from a prudential point of view and justified by exceptional circumstances;

(e) the Additional Tier 1 or Tier 2 instruments are repurchased for market making purposes.

Approval to reduce eligible liabilities instruments.

78A.(1) The resolution authority, in deciding whether to grant an approval for an institution to call, redeem, repay or repurchase eligible liabilities instruments, must take into account whether one of the following conditions is met–

(a) before or at the same time as any of the actions referred to in Article 77(2), the institution replaces the eligible liabilities instruments with own funds or eligible liabilities instruments of equal or higher quality at terms that are sustainable for the income capacity of the institution;

(b) the institution has demonstrated to the satisfaction of the resolution authority that the own funds and eligible liabilities of the institution would, following the action referred to in Article 77(2), exceed the requirements for own funds and eligible liabilities laid down in these Standards and in the CICR Regulations and the Recovery and Resolution Regulations by a margin that the resolution authority, in agreement with the competent authority, considers necessary;

(c) the institution has demonstrated to the satisfaction of the resolution authority that the partial or full replacement of the eligible liabilities with own funds instruments

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

is necessary to ensure compliance with the own funds requirements laid down in these Standards and in the CICR Regulations for continuing authorisation.

Where an institution provides sufficient safeguards as to its capacity to operate with own funds and eligible liabilities above the amount of the requirements laid down in these Standards and in the CICR Regulations and the Recovery and Resolution Regulations, the resolution authority, after consulting the GFSC, may grant that institution a general approval to effect calls, redemptions, repayments or repurchases of eligible liabilities instruments, subject to criteria that ensure that any such future action will be in accordance with the conditions set out in sub-paragraphs (a) and (b). That general approval must be granted only for a specified period, which must not exceed one year, after which it may be renewed. The general approval must be granted for a certain predetermined amount, which is set by the resolution authority. The resolution authority must inform the GFSC about any general approval granted.

The resolution authority must withdraw the general approval where an institution breaches any of the criteria provided for the purposes of that approval.

(2) When assessing the sustainability of the replacement instruments for the income capacity of the institution referred to in paragraph (1)(a), the resolution authority must consider the extent to which those replacement capital instruments or replacement eligible liabilities would be more costly for the institution than those they would replace.

Temporary waiver from deduction from own funds and eligible liabilities.

79.(1) Where–

(a) an institution holds capital instruments or liabilities that qualify as own funds instruments in a financial sector entity or an institution; and

(b) the GFSC considers those holdings to be for the purposes of a financial assistance operation designed to reorganise and restore the viability of that entity or institution,

the GFSC may waive or modify on a temporary basis the provisions on deduction that would otherwise apply to those instruments.

(2) A waiver or modification under paragraph (1) is to be treated for the purposes of these Standards as if it were a GFSC Art. 5A(4) approval.

Assessment of compliance with the conditions for own funds and eligible liabilities instruments.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

79A. Institutions must have regard to the substantial features of instruments and not only their legal form when assessing compliance with the requirements laid down in Part 2. The assessment of the substantial features of an instrument must take into account all arrangements related to the instruments, even where those are not explicitly set out in the terms and conditions of the instruments themselves, for the purpose of determining that the combined economic effects of such arrangements are compliant with the objective of the relevant provisions.

80. [Not used]

TITLE 2
MINORITY INTEREST AND ADDITIONAL TIER 1 AND TIER 2 INSTRUMENTS ISSUED BY SUBSIDIARIES

Minority interests that qualify for inclusion in consolidated Common Equity Tier 1 capital.

81.(1) Minority interests must comprise the sum of Common Equity Tier 1 items of a subsidiary where the following conditions are met–

(a) the subsidiary is one of the following–

(i) an institution;

(ii) an undertaking that is subject to these Standards and the CICR Regulations;

(iii) an intermediate financial holding company or intermediate mixed financial holding company that is subject to these Standards on a sub-consolidated basis, or an intermediate investment holding company that is subject to the IFPR Regulations on a consolidated basis;

(iv) an investment firm;

(v) an intermediate financial holding company in a third country that is subject to prudential requirements as stringent as those applied to credit institutions of that third country, where the Minister has determined in accordance with Article 107(4) that those prudential requirements are at least equivalent to those of these Standards;

(b) the subsidiary is included fully in the consolidation pursuant to Chapter 2 of Title 2 of Part 1;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(c) the Common Equity Tier 1 items, referred to in the introductory part of this paragraph, are owned by persons other than the undertakings included in the consolidation pursuant to Chapter 2 of Title 2 of Part 1.

(2) Minority interests that are funded directly or indirectly, through a special purpose entity or otherwise, by the parent undertaking of the institution, or its subsidiaries must not qualify as consolidated Common Equity Tier 1 capital.

Qualifying Additional Tier 1, Tier 1, Tier 2 capital and qualifying own funds.

82. Qualifying Additional Tier 1, Tier 1, Tier 2 capital and qualifying own funds must comprise the minority interest, Additional Tier 1 or Tier 2 instruments, as applicable, plus the related retained earnings and share premium accounts, of a subsidiary where the following conditions are met–

(a) the subsidiary is one of the following–

(i) an institution;

(ii) an undertaking that is subject to these Standards and the CICR Regulations;

(iii) an intermediate financial holding company or intermediate mixed financial holding company that is subject to these Standards on a sub-consolidated basis, or an intermediate investment holding company that is subject to the IFPR Regulations on a consolidated basis;

(iv) an investment firm;

(v) an intermediate financial holding company in a third country that is subject to prudential requirements as stringent as those applied to credit institutions of that third country, where the Minister has determined in accordance with Article 107(4) that those prudential requirements are at least equivalent to those of these Standards;

(b) the subsidiary is included fully in the scope of consolidation pursuant to Chapter 2 of Title 2 of Part 1;

(c) those instruments are owned by persons other than the undertakings included in the consolidation pursuant to Chapter 2 of Title 2 of Part 1.

83. [Not used]

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Minority interests included in consolidated Common Equity Tier 1 capital.

84.(1) Institutions must determine the amount of minority interests of a subsidiary that is included in consolidated Common Equity Tier 1 capital by subtracting from the minority interests of that undertaking the result of multiplying the amount in sub-paragraph (a) by the percentage in sub-paragraph (b) as follows–

(a) the Common Equity Tier 1 capital of the subsidiary minus the lower of the following–

(i) the amount of Common Equity Tier 1 capital of that subsidiary required to meet the following–

(aa) the sum of the requirement laid down Article 92(1)(a), the requirements referred to in Articles 458 and 459, the specific own funds requirements referred to in regulation 140 of the CICR Regulations, the combined buffer requirement defined in regulation 82(1) of those Regulations and any additional local supervisory regulations in third countries so far as those requirements are to be met by Common Equity Tier 1 capital;

(bb) where the subsidiary is an investment firm, the sum of the requirement in regulation 14 of the IFPR Regulations, the specific own funds requirements in regulation 91(2)(a) of those Regulations and any additional local supervisory regulations in third countries, insofar as those requirements are to be met by Common Equity Tier 1 capital;

(ii) the amount of consolidated Common Equity Tier 1 capital that relates to that subsidiary that is required on a consolidated basis to meet the sum of the requirement in Article 92(1)(a), the requirements referred to in Articles 458 and 459, the specific own funds requirements referred to in regulation 140 of the CICR Regulations, the combined buffer requirement defined in regulation 82(1) of those Regulations, and the requirements referred to in any additional local supervisory regulations in third countries insofar as those requirements are to be met by Common Equity Tier 1 capital;

(b) the minority interests of the subsidiary expressed as a percentage of all Common Equity Tier 1 instruments of that undertaking plus the related share premium accounts, retained earnings and other reserves.

(2) The calculation referred to in paragraph (1) must be undertaken on a sub-consolidated basis for each subsidiary referred to in Article 81(1).

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

An institution may choose not to undertake this calculation for a subsidiary referred to in Article 81(1). Where an institution takes such a decision, the minority interest of that subsidiary may not be included in consolidated Common Equity Tier 1 capital.

(3) Where the GFSC derogates from the application of prudential requirements on an individual basis under Article 7, minority interests within the subsidiaries to which the waiver is applied must not be recognised in own funds at the sub-consolidated or at the consolidated level, as applicable.

(4) [Not used]

(5) The GFSC may grant a GFSC Art.5A(4) approval to waive the application of this Article to a parent financial holding company or a parent mixed financial holding company that satisfies all the following conditions–

(a) its principal activity is to acquire holdings;

(b) it is subject to prudential supervision on a consolidated basis;

(c) it consolidates a subsidiary institution in which it has only a minority holding and which is a subsidiary because of section 276 of the Companies Act 2014;

(d) more than 90% of the consolidated required Common Equity Tier 1 capital arises from the subsidiary institution referred to in sub-paragraph (c) calculated on a sub-consolidated basis.

Qualifying Tier 1 instruments included in consolidated Tier 1 capital.

85.(1) Institutions must determine the amount of qualifying Tier 1 capital of a subsidiary that is included in consolidated own funds by subtracting from the qualifying Tier 1 capital of that undertaking the result of multiplying the amount in sub-paragraph (a) by the percentage in sub-paragraph (b) as follows–

(a) the Tier 1 capital of the subsidiary minus the lower of the following–

(i) the amount of Tier 1 capital of the subsidiary required to meet the following–

(aa) the sum of the requirement laid down in Article 92(1)(b), the requirements referred to in Articles 458 and 459, the specific own funds requirements referred to in regulation 140 of the CICR

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Regulations, the combined buffer requirement defined in regulation 82(1) of those Regulations, and any additional local supervisory regulations in third countries insofar as those requirements are to be met by Tier 1 Capital;

(bb) where the subsidiary is an investment firm, the sum of the requirement in regulation 14 of the IFPR Regulations, the specific own funds requirements in regulation 91(2)(a) of those Regulations and any additional local supervisory regulations in third countries so far as those requirements are to be met by Common Equity Tier 1 capital;

(ii) the amount of consolidated Tier 1 capital that relates to the subsidiary that is required on a consolidated basis to meet the sum of the requirement laid down in Article 92(1)(b), the requirements referred to in Articles 458 and 459, the specific own funds requirements referred to in regulation 140 of the CICR Regulations, the combined buffer requirement defined in regulation 82(1) of those Regulations, and any additional local supervisory regulations in third countries insofar as those requirements are to be met by Tier 1 Capital;

(b) the qualifying Tier 1 capital of the subsidiary expressed as a percentage of all Tier 1 instruments of that undertaking plus the related share premium accounts, retained earnings and other reserves.

(2) The calculation referred to in paragraph (1) must be undertaken on a sub-consolidated basis for each subsidiary referred to in Article 81(1).

An institution may choose not to undertake this calculation for a subsidiary referred to in Article 81(1). Where an institution takes such a decision, the qualifying Tier 1 capital of that subsidiary may not be included in consolidated Tier 1 capital.

(3) Where the GFSC derogates from the application of prudential requirements on an individual basis under Article 7 or, as applicable, regulation 8 of the IFPR Regulations, Tier 1 instruments within the subsidiaries to which the waiver is applied must not be recognised as own funds at the sub-consolidated or at the consolidated level, as applicable.

Qualifying Tier 1 capital included in consolidated Additional Tier 1 capital.

86. Without prejudice to Article 84(5), institutions must determine the amount of qualifying Tier 1 capital of a subsidiary that is included in consolidated Additional Tier 1 capital by subtracting from the qualifying Tier 1 capital of that undertaking included in consolidated Tier

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

1 capital the minority interests of that undertaking that are included in consolidated Common Equity Tier 1 capital.

Qualifying own funds included in consolidated own funds.

87.(1) Institutions must determine the amount of qualifying own funds of a subsidiary that is included in consolidated own funds by subtracting from the qualifying own funds of that undertaking the result of multiplying the amount in sub-paragraph (a) by the percentage in sub-paragraph (b) as follows–

(a) the own funds of the subsidiary minus the lower of the following–

(i) the amount of own of the subsidiary required to meet the following–

(aa) the sum of the requirement laid down in Article 92(1)(c), the requirements referred to in Articles 458 and 459, the specific own funds requirements referred to in regulation 140 of the CICR Regulations, the combined buffer requirement defined in regulation 82(1) of those Regulations, and any additional local supervisory regulations in third countries;

(bb) where the subsidiary is an investment firm, the sum of the requirement in regulation 14 of the IFPR Regulations, the specific own funds requirements in regulation 91(2)(a) of those Regulations and any additional local supervisory regulations in third countries;

(ii) the amount of own funds that relates to the subsidiary that is required on a consolidated basis to meet the sum of the requirement laid down in Article 92(1)(c), the requirements referred to in Articles 458 and 459, the specific own funds requirements referred to in regulation 140 of the CICR Regulations, the combined buffer requirement defined in regulation 82(1) of those Regulations, and any additional local supervisory own funds requirement in third countries;

(b) the qualifying own funds of the undertaking, expressed as a percentage of the sum of all Common Equity Tier 1, Additional Tier 1 items and Tier 2 items and the related share premium accounts, the retained earnings and other reserves.

(2) The calculation referred to in paragraph (1) must be undertaken on a sub-consolidated basis for each subsidiary referred to in Article 81(1).

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

An institution may choose not to undertake this calculation for a subsidiary referred to in Article 81(1). Where an institution takes such a decision, the qualifying own funds of that subsidiary may not be included in consolidated own funds.

(3) Where the GFSC derogates from the application of prudential requirements on an individual basis under Article 7, own funds instruments within the subsidiaries to which the waiver is applied must not be recognised as own funds at the sub-consolidated or at the consolidated level, as applicable.

Qualifying own funds instruments included in consolidated Tier 2 capital.

88. Without prejudice to Article 84(5), institutions must determine the amount of qualifying own funds of a subsidiary that is included in consolidated Tier 2 capital by subtracting from the qualifying own funds of that undertaking that are included in consolidated own funds the qualifying Tier 1 capital of that undertaking that is included in consolidated Tier 1 capital.

TITLE 3
QUALIFYING HOLDINGS OUTSIDE THE FINANCIAL SECTOR

Risk weighting and prohibition of qualifying holdings outside the financial sector.

89.(1) A qualifying holding, the amount of which exceeds 15% of the eligible capital of the institution, in an undertaking which is not one of the following must be subject to the provisions laid down in paragraph (3)–

(a) a financial sector entity;

(b) an undertaking, that is not a financial sector entity, carrying on activities which the GFSC considers to be any of the following–

(i) a direct extension of banking;

(ii) ancillary to banking;

(iii) leasing, factoring, the management of unit trusts, the management of data processing services or any other similar activity.

(2) The total amount of the qualifying holdings of an institution in undertakings other than those referred to in paragraph (1)(a) and (b) that exceeds 60% of its eligible capital must be subject to the provisions laid down in paragraph (3).

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(3) –For the purpose of calculating the capital requirement in accordance with Part 3, institutions must apply a risk weight of 1,250% to the greater of the following–

(a) the amount of qualifying holdings referred to in paragraph (1) in excess of 15% of eligible capital;

(b) the total amount of qualifying holdings referred to in paragraph (2) that exceed 60% of the eligible capital of the institution.

Alternative to 1,250% risk weight.

90. As an alternative to applying a 1,250% risk weight to the amounts in excess of the limits specified in Article 89(1) and (2), institutions may deduct those amounts from Common Equity Tier 1 items in accordance with Article 36(1)(k).

Exceptions.

91.(1) Shares of undertakings not referred to Article 89(1)(a) and (b) must not be included in calculating the eligible capital limits specified in that Article where any of the following conditions is met–

(a) those shares are held temporarily during a financial assistance operation as referred to in Article 79;

(b) the holding of those shares is an underwriting position held for five working days or fewer;

(c) those shares are held in the own name of the institution and on behalf of others.

(2) Shares which are not participating interests, shares in affiliated undertakings or securities intended for use on a continuing basis in the normal course of an undertaking's activities must not be included in the calculation specified in Article 89.

PART 3
CAPITAL REQUIREMENTS

TITLE 1
GENERAL REQUIREMENTS, VALUATION AND REPORTING

CHAPTER 1
REQUIRED LEVEL OF OWN FUNDS

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Own funds requirements for institutions

Own funds requirements.

92.(1) Subject to Articles 93 and 94, institutions must at all times satisfy the following own funds requirements–

(a) a Common Equity Tier 1 capital ratio of 4.5%;

(b) a Tier 1 capital ratio of 6%;

(c) a total capital ratio of 8%.

(d) a leverage ratio of 3.25%;

(1A) In addition to the requirement in paragraph (1)(d), a G-SII must maintain a leverage ratio buffer equal to the G-SII's total exposure measure referred to in Article 429(4) multiplied by 50% of the G-SII buffer rate applicable to the G-SII in accordance with regulation 85 of the CICR Regulations.

A G-SII must meet the leverage ratio buffer requirement with Tier 1 capital only. Tier 1 capital that is used to meet the leverage ratio buffer requirement must not be used towards meeting any of the leverage based requirements set out in these Standards and the CICR Regulations, unless either enactment explicitly provides otherwise.

Where a G-SII does not meet the leverage ratio buffer requirement, it must be subject to the capital conservation requirement in accordance with regulation 94B of the CICR Regulations.

Where a G-SII does not meet at the same time the leverage ratio buffer requirement and the combined buffer requirement as defined in regulation 82 of the CICR Regulations, it must be subject to the higher of the capital conservation requirements in accordance with regulations 94 and 94B of those Regulations.

(2) Institutions must calculate their capital ratios as follows–

(a) the Common Equity Tier 1 capital ratio is the Common Equity Tier 1 capital of the institution expressed as a percentage of the total risk exposure amount;

(b) the Tier 1 capital ratio is the Tier 1 capital of the institution expressed as a percentage of the total risk exposure amount;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(c) the total capital ratio is the own funds of the institution expressed as a percentage of the total risk exposure amount.

(3) Total risk exposure amount must be calculated as the sum of sub-paragraphs (a) to (f) after taking into account the provisions laid down in paragraph (4)–

(a) the risk-weighted exposure amounts for credit risk and dilution risk, calculated in accordance with Title 2 and Article 379, in respect of all the business activities of an institution, excluding risk-weighted exposure amounts from the trading book business of the institution;

(b) the own funds requirements for the trading-book business of an institution for the following–

(i) market risk as determined in accordance with Title 4 of this Part, excluding the approaches set out in Chapters 1a and 1b of that Title;

(ii) large exposures exceeding the limits specified in Articles 395 to 401, to the extent that an institution is permitted to exceed those limits, as determined in accordance with Part 4;

(c) the own funds requirements for market risk as determined in Title 4 of this Part, excluding the approaches set out in Chapters 1a and 1b of that Title, for all business activities that are subject to foreign exchange risk or commodity risk;

(ca) the own funds requirements calculated in accordance with Title 5 of this Part, with the exception of Article 379 for settlement risk;

(d) the own funds requirements calculated in accordance with Title 6 for credit valuation adjustment risk of OTC derivative instruments other than credit derivatives recognised to reduce risk-weighted exposure amounts for credit risk;

(e) the own funds requirements determined in accordance with Title 3 for operational risk;

(f) the risk-weighted exposure amounts determined in accordance with Title 2 for counterparty risk arising from the trading book business of the institution for the following types of transactions and agreements–

(i) contracts listed in Schedule 2 and credit derivatives;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(ii) repurchase transactions, securities or commodities lending or borrowing transactions based on securities or commodities;

(iii) margin lending transactions based on securities or commodities;

(iv) long settlement transactions.

(4) The following provisions apply in the calculation of the total risk exposure amount referred to in paragraph (3)–

(a) the own funds requirements referred to in sub-paragraphs (c), (d) and (e) of that paragraph must include those arising from all the business activities of an institution;

(b) institutions must multiply the own funds requirements set out in sub-paragraphs (b) to (e) of that paragraph by 12.5.

Requirements for own funds and eligible liabilities for G-SIIs.

92A.(1) Subject to Articles 93 and 94 and to the exceptions set out in paragraph (2), institutions identified as resolution entities and that are a G-SII or part of a G-SII must at all times satisfy the following requirements for own funds and eligible liabilities–

(a) a risk-based ratio of 18%, representing the own funds and eligible liabilities of the institution expressed as a percentage of the total risk exposure amount calculated in accordance with Article 92(3) and (4);

(b) a non-risk-based ratio of 6.75%, representing the own funds and eligible liabilities of the institution expressed as a percentage of the total exposure measure referred to in Article 429(4).

(2) The requirements laid down in paragraph (1) must not apply in the following cases–

(a) within the three years following the date on which the institution or the group of which the institution is part has been identified as a G-SII;

(b) within the two years following the date on which the resolution authority has applied the bail-in tool in accordance with the Recovery and Resolution Regulations;

(c) within the two years following the date on which the resolution entity has put in place an alternative private sector measure by which capital instruments and other

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

liabilities have been written down or converted into Common Equity Tier 1 items in order to recapitalise the resolution entity without the application of resolution tools.

Requirement for own funds and eligible liabilities for third-country G-SIIs.

92B.(1) Institutions that are material subsidiaries of third-country G-SIIs and that are not resolution entities must at all times satisfy requirements for own funds and eligible liabilities equal to 90% of the requirements for own funds and eligible liabilities laid down in Article 92A.

(2) For the purpose of complying with paragraph (1), Additional Tier 1, Tier 2 and eligible liabilities instruments must only be taken into account where those instruments are owned by the ultimate parent undertaking of the third-country G-SII and have been issued directly or indirectly through other entities within the same group, if all such entities are established in the same third country as that ultimate parent undertaking or in Gibraltar.

(3) An eligible liabilities instrument must only be taken into account for the purpose of complying with paragraph (1) where it fulfils all the following additional conditions–

(a) in the event of normal insolvency proceedings as defined in regulation 3(1) of the Recovery and Resolution Regulations, the claim resulting from the liability ranks below claims resulting from liabilities that do not fulfil the conditions set out in paragraph (2) and that do not qualify as own funds;

(b) it is subject to the write-down or conversion powers under regulations 59 to 62 of those Regulations.

Initial capital requirement on going concern.

93.(1) The own funds of an institution may not fall below the amount of initial capital required at the time of its authorisation.

(2) Credit institutions that were already in existence on 1 January 1993, the amount of own funds of which do not attain the amount of initial capital required may continue to carry out their activities. In that event, the amount of own funds of those institutions may not fall below the highest level reached with effect from 22 December 1989.

(3) [Not used]

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(4) Where control of an institution to which paragraph (2) applies is taken by an individual or legal person other than the person who controlled the institution previously, the amount of own funds of that institution must attain the amount of initial capital required.

(5) Where there is a merger of two or more institutions to which paragraph (2) applies, the amount of own funds of the institution resulting from the merger must not fall below the total own funds of the merged institutions at the time of the merger, as long as the amount of initial capital required has not been attained.

(6) If the GFSC considers that it is necessary for an institution to comply with paragraph (1) in order to guarantee its solvency, the provisions of paragraphs (2), (4) and (5) do not apply.

Derogation for small trading book business.

94.(1) By way of derogation from Article 92(3)(b), institutions may calculate the own funds requirement for their trading-book business in accordance with paragraph (2), where the size of the institutions' on- and off-balance-sheet trading-book business is equal to or less than both of the following thresholds on the basis of an assessment carried out on a monthly basis using the data as of the last day of the month–

(a) 5% of the institution's total assets; and

(b) £44 million.

(2) Where both conditions in paragraph (1) are met, institutions may calculate the own funds requirement for their trading-book business as follows–

(a) for the contracts listed in paragraph (1) of Schedule 2, contracts relating to equities which are referred to in paragraph (3) of that Schedule and credit derivatives, institutions may exempt those positions from the own funds requirement in Article 92(3)(b); and

(b) for trading book positions other than those in sub-paragraph (a), institutions may replace the own funds requirement in Article 92(3)(b) with the requirement calculated in accordance with Article 92(3)(a).

(3) Institutions must calculate the size of their on- and off-balance-sheet trading book business on the basis of data as of the last day of each month for the purposes of paragraph (1) in accordance with the following requirements–

(a) all the positions assigned to the trading book in accordance with Article 104 must be included in the calculation except for the following–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(i) positions concerning foreign exchange and commodities; and

(ii) positions in credit derivatives that are recognised as internal hedges against non-trading book credit risk exposures or counterparty risk exposures and the credit derivate transactions that perfectly offset the market risk of those internal hedges as referred to in Article 106(3);

(b) all positions included in the calculation in accordance with sub-paragraph (a) must be valued at their market value on that given date; where the market value of a position is not available on a given date, institutions must take a fair value for the position on that date; where the market value and fair value of a position are not available on a given date, institutions must take the most recent of the market value or fair value for that position; and

(c) the absolute value of long positions must be summed with the absolute value of short positions.

(4) Where both conditions in paragraph (1) are met, irrespective of the obligations set out in regulations 31 and 40 of the CICR Regulations, Article 102(3) and (4), 103 and 104B do not apply.

(5) Institutions must notify the GFSC when they calculate, or cease to calculate, the own funds requirements of their trading-book business in accordance with paragraph (2).

(6) An institution that no longer meets one or more of the conditions in paragraph (1) must immediately notify the GFSC of that fact.

(7) An institution must cease to calculate the own funds requirements of its trading-book business in accordance with paragraph (2) within three months of one of the following occurring–

(a) the institution does not meet the conditions set out in paragraph (1)(a) or (b) for three consecutive months; or

(b) the institution does not meet the conditions set out in paragraph (1)(a) or (b) during more than 6 out of the last 12 months.

(8) Where an institution has ceased to calculate the own funds requirements of its trading-book business in accordance with this Article, it may only be permitted to calculate the own funds requirements of its trading-book business in accordance with this Article where it

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

demonstrates to the GFSC that all the conditions in paragraph (1) have been met for an uninterrupted full-year period.

(9) Institutions must not enter into, buy or sell a trading-book position for the sole purpose of complying with any of the conditions set out in paragraph (1) during the monthly assessment.

Own funds requirements for investment firms with limited authorisation to provide investment services

Own funds requirements for investment firms with limited authorisation to provide investment services.

95.(1) For the purposes of Article 92(3), investment firms that are not authorised to provide the investment services and activities listed in paragraphs 50 and 53 of Schedule 2 to the Act must use the calculation of the total risk exposure amount specified in paragraph (2).

(2) Investment firms referred to in paragraph (1) and legacy firms that provide the investment services and activities listed in paragraphs 49 and 51 of Schedule 2 to the Act must calculate the total risk exposure amount as the higher of the following–

(a) the sum of the items referred to in Article 92(3)(a) to (d) and (f) after applying Article 92(4);

(b) 12.5 multiplied by the amount specified in Article 97.

Legacy firms that provide the investment services and activities listed in paragraphs 49 and 51 of Schedule 2 to the Act must meet the requirements in Article 92(1) and (2) based on the total risk exposure amount referred to in the first sub-paragraph.

The GFSC may set the own funds requirements for legacy firms that provide the investment services and activities listed in points (2) and (4) of Section A of Annex I to Directive 2004/39/EC as the own funds requirements that would apply to those firms under the law of Gibraltar which transposed Directives 2006/49/EC and 2006/48/EC, as it had effect on 31 December 2013.

(3) Investment firms referred to in paragraph (1) are subject to all other provisions regarding operational risk in regulations 33 to 44 of the CICR Regulations.

(4) In this Article “legacy firm” means a firm within the meaning of Article 4.1(2)(c) of Regulation (EU) No 575/2013 as it applied on or before 31st December 2020.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(5) This Article ceases to have effect from 31st December 2026.

Own funds requirements for Regulation 19(2) investment firms.

96.(1) For the purposes of Article 92(3), the following categories of investment firm which hold initial capital in accordance with regulation 19(2) of the CICR Regulations must use the calculation of the total risk exposure amount specified in paragraph (2)–

(a) investment firms that deal on own account only for the purpose of fulfilling or executing a client order or for the purpose of gaining entrance to a clearing and settlement system or a recognised exchange when acting in an agency capacity or executing a client order;

(b) investment firms that meet all the following conditions–

(i) they do not hold client money or securities;

(ii) they undertake only dealing on own account;

(iii) they have no external customers;

(iv) their execution and settlement transactions take place under the responsibility of a clearing institution and are guaranteed by that clearing institution.

(2) For investment firms referred to in paragraph (1), total risk exposure amount must be calculated as the sum of the following–

(a) Article 92(3)(a) to (d) and (f) after applying Article 92(4);

(b) the amount referred to in Article 97 multiplied by 12.5.

(3) Investment firms referred to in paragraph (1) are subject to all other provisions regarding operational risk in regulations 33 to 44 of the CICR Regulations.

(4) This Article ceases to have effect from 31st December 2026.

Own Funds based on Fixed Overheads.

97.(1) In accordance with Articles 95 and 96, an investment firm that provide the investment services and activities listed in paragraphs 49 and 51 of Schedule 2 to the Act must hold eligible capital of at least one quarter of the fixed overheads of the preceding year.

(2) Where there is a change in the business of an investment firm since the preceding year that the competent authority considers to be material, the competent authority may adjust the requirement laid down in paragraph (1).

(3) Where an investment firm has not completed business for one year, starting from the day it starts up, an investment firm must hold eligible capital of at least one quarter of the fixed overheads projected in its business plan, except where the competent authority requires the business plan to be adjusted.

(4) [Not used]

(5) This Article ceases to have effect from 31st December 2026.

Own funds for investment firms on a consolidated basis.

98.(1) In the case of the investment firms referred to in Article 95(1) in a group, where that group does not include credit institutions, a Gibraltar parent investment firm must apply Article 92 at a consolidated level as follows–

(a) using the calculation of total risk exposure amount specified in Article 95(2);

(b) own funds calculated on the basis of the consolidated situation of the parent investment firm or that of the financial holding company or mixed financial holding company, as applicable.

(2) In the case of investment firms referred to in Article 96(1) in a group, where that group does not include credit institutions, a Gibraltar parent investment firm and an investment firm controlled by a financial holding company or mixed financial holding company must apply Article 92 on a consolidated basis as follows–

(a) it must use the calculation of total risk exposure amount specified in Article 96(2);

(b) it must use own funds calculated on the basis of the consolidated situation of the parent investment firm or that of the financial holding company or mixed financial holding company, as applicable, and in compliance with Chapter 2 of Title 2 of Part 1.

(3) In this Article "Gibraltar parent investment firm" means an investment firm in Gibraltar which has an institution or financial institution as a subsidiary or which holds a participation in such an institution or financial institution, and which is not itself a subsidiary of another

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

institution authorised in Gibraltar, or of a financial holding company or mixed financial holding company set up in Gibraltar.

(4) This Article ceases to have effect from 31st December 2026.

99. to 101. [Not used]

Trading book

Requirements for the trading book.

102.(1) Positions in the trading book must be either free of restrictions on their tradability or able to be hedged.

(2) Trading intent must be evidenced on the basis of the strategies, policies and procedures set up by the institution to manage the position or portfolio in accordance with Articles 103, 104 and 104A.

(3) Institutions must establish and maintain systems and controls to manage their trading book in accordance with Article 103.

(4) For the purposes of the reporting requirements set out in Article 430B(3) (to the extent it applies on or after 1st February 2026), trading book positions must be assigned to trading desks established in accordance with Article 104B.

(5) Positions in the trading book are subject to the requirements for prudent valuation specified in Article 105.

(6) Institutions must treat internal hedges in accordance with Article 106.

Management of the trading book.

103.(1) Institutions must have in place clearly defined policies and procedures for the overall management of the trading book. Those policies and procedures must at least address–

(a) the activities which the institution considers to be trading business and as constituting part of the trading book for own funds requirement purposes;

(b) the extent to which a position can be marked-to-market daily by reference to an active, liquid two-way market;

(c) for positions that are marked-to-model, the extent to which the institution can–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(i) identify all material risks of the position;

(ii) hedge all material risks of the position with instruments for which an active, liquid two-way market exists;

(iii) derive reliable estimates for the key assumptions and parameters used in the model;

(d) the extent to which the institution can, and is required to, generate valuations for the position that can be validated externally in a consistent manner;

(e) the extent to which legal restrictions or other operational requirements would impede the institution's ability to effect a liquidation or hedge of the position in the short term;

(f) the extent to which the institution can, and is required to, actively manage the risks of positions within its trading operation; and

(g) the extent to which the institution may reclassify risk or positions between the non-trading and trading books and the requirements for such reclassifications as referred to in Article 104A.

(2) In managing its positions or portfolios of positions in the trading book, the institution must comply with all the following requirements–

(a) the institution must have in place a clearly documented trading strategy for the position or portfolios in the trading book, which must be approved by senior management and include the expected holding period;

(b) the institution must have in place clearly defined policies and procedures for the active management of positions or portfolios in the trading book; those policies and procedures must include the following–

(i) which positions or portfolios of positions may be entered into by each trading desk or, as the case may be, by designated dealers;

(ii) the setting of position limits and monitoring them for appropriateness;

(iii) ensuring that dealers have the autonomy to enter into and manage the position within agreed limits and according to the approved strategy;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(iv) ensuring that positions are reported to senior management as an integral part of the institution's risk management process;

(v) ensuring that positions are actively monitored with reference to market information sources and an assessment is made of the marketability or hedgeability of the position or its component risks, including the assessment, the quality and availability of market inputs to the valuation process, level of market turnover, sizes of positions traded in the market;

(vi) active anti-fraud procedures and controls;

(c) the institution must have in place clearly defined policies and procedures to monitor the positions against the institution's trading strategy, including the monitoring of turnover and positions for which the originally intended holding period has been exceeded.

Inclusion in the trading book.

104.(1) Institutions must have in place clearly defined policies and procedures for determining which position to include in the trading book for the purposes of calculating their capital requirements, in accordance with the requirements set out in Article 102 and the definition of trading book in accordance with Article 4(1), taking into account the institution's risk management capabilities and practices. The institution must fully document its compliance with these policies and procedures and must subject them to periodic internal audit.

(2) [Not used]

Reclassification of a position.

104A.(1) Institutions must have in place clearly defined policies for identifying the exceptional circumstances which justify the reclassification of a trading book position as a non-trading book position or, conversely, the reclassification of a non-trading book position as a trading book position, for the purpose of determining their own funds requirements to the satisfaction of the GFSC. The institutions must review those policies at least annually.

(2) The GFSC may grant approval to reclassify a trading book position as a non-trading book position or conversely a non-trading book position as a trading book position for the purpose of determining an institution's own funds requirements only where the institution has provided the GFSC with written evidence that its decision to reclassify that position is the result of an exceptional circumstance that is consistent with the policies the institution has in place in accordance with paragraph (1) and, for that purpose, the institution must provide sufficient

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

evidence that the position no longer meets the condition to be classified as a trading book or non-trading book position pursuant to Article 104.

The decision referred to in the first sub-paragraph must be approved by the management body.

(3) Where the GFSC has granted approval for the reclassification of a position in accordance with paragraph (2), the institution which received that approval must–

(a) publicly disclose, without delay;

(i) information that its position has been reclassified; and

(ii) where the effect of that reclassification is a reduction in the institution’s own funds requirements, the size of that reduction; and

(b) where the effect of that reclassification is a reduction in the institution’s own funds requirements, not recognise that effect until the position matures, unless the GFSC permits it to recognise that effect at an earlier date.

(4) The institution must calculate the net change in the amount of its own funds requirements arising from the reclassification of the position as the difference between the own funds requirements immediately after the reclassification and the own funds requirements immediately before the reclassification, each calculated in accordance with Article 92. The calculation must not take into account the effects of any factors other than the reclassification.

(5) The reclassification of a position in accordance with this Article must be irrevocable.

Requirements for trading desk.

104B.(1) For the purposes of the reporting requirements set out in Article 430B(3) (to the extent it applies on or after 1st February 2026), institutions must establish trading desks and assign each of their trading book positions to one of those trading desks. Trading book positions must be attributed to the same trading desk only where they satisfy the agreed business strategy for the trading desk and are consistently managed and monitored in accordance with paragraph (2).

(2) Institutions' trading desks must at all times meet all the following requirements–

(a) each trading desk must have a clear and distinctive business strategy and a risk management structure that is adequate for its business strategy;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(b) each trading desk must have a clear organisational structure with positions managed by designated dealers within the institution, and each dealer must have dedicated functions in the trading desk and be assigned to one trading desk only;

(c) position limits must be set within each trading desk according to the business strategy of that trading desk;

(d) reports on the activities, profitability, risk management and regulatory requirements at the trading desk level must be produced at least on a weekly basis and communicated to the management body on a regular basis;

(e) each trading desk must have a clear annual business plan including a well-defined remuneration policy on the basis of sound criteria used for performance measurement;

(f) reports on maturing positions, intra-day trading limit breaches, daily trading limit breaches and actions taken by the institution to address those breaches, as well as assessments of market liquidity, must be prepared for each trading desk on a monthly basis and made available to the GFSC.

(3) By way of derogation from paragraph (2)(b), an institution may assign a dealer to more than one trading desk, if the institution demonstrates to the satisfaction of the GFSC that the assignment has been made due to business or resource considerations and the assignment preserves the other qualitative requirements set out in this Article applicable to dealers and trading desks.

(4) Institutions must notify the GFSC of the manner in which they comply with paragraph (2). The GFSC may require an institution to change the structure or organisation of its trading desks to comply with this Article.

Requirements for prudent valuation.

105.(1) All trading book positions and non-trading book positions measured at fair value must be subject to the standards for prudent valuation specified in this Article. Institutions must in particular ensure that the prudent valuation of their trading book positions achieves an appropriate degree of certainty having regard to the dynamic nature of trading book positions and non-trading book positions measured at fair value, the demands of prudential soundness and the mode of operation and purpose of capital requirements in respect of trading book positions and non-trading book positions measured at fair value.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(2) Institutions must establish and maintain systems and controls sufficient to provide prudent and reliable valuation estimates. Those systems and controls must include at least the following elements–

(a) documented policies and procedures for the process of valuation, including clearly defined responsibilities of the various areas involved in the determination of the valuation, sources of market information and review of their appropriateness, guidelines for the use of unobservable inputs reflecting the institution's assumptions of what market participants would use in pricing the position, frequency of independent valuation, timing of closing prices, procedures for adjusting valuations, month end and ad-hoc verification procedures;

(b) reporting lines for the department accountable for the valuation process that are clear and independent of the front office, which must ultimately be to the management body.

(3) Institutions must revalue trading book positions at fair value at least on a daily basis. Changes in the value of those positions must be reported in the profit and loss account of the institution.

(4) Institutions must mark their trading book positions and non-trading book positions measured at fair value to market whenever possible, including when applying the relevant capital treatment to those positions.

(5) When marking to market, an institution must use the more prudent side of bid and offer unless the institution can close out at mid-market. Where institutions make use of this derogation, they must every six months inform the GFSC of the positions concerned and furnish evidence that they can close out at mid-market.

(6) Where marking to market is not possible, institutions must conservatively mark to model their positions and portfolios, including when calculating own funds requirements for positions in the trading book and positions measured at fair value in the non-trading book.

(7) Institutions must comply with the following requirements when marking to model–

(a) senior management must be aware of the elements of the trading book or of other fair-valued positions which are subject to mark to model and understand the materiality of the uncertainty thereby created in the reporting of the risk/performance of the business;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(b) institutions must source market inputs, where possible, in line with market prices, and assess the appropriateness of the market inputs of the particular position being valued and the parameters of the model on a frequent basis;

(c) where available, institutions must use valuation methodologies which are accepted market practice for particular financial instruments or commodities;

(d) where the model is developed by the institution itself, it must be based on appropriate assumptions, which have been assessed and challenged by suitably qualified parties independent of the development process;

(e) institutions must have in place formal change control procedures and hold a secure copy of the model and use it periodically to check valuations;

(f) risk management must be aware of the weaknesses of the models used and how best to reflect those in the valuation output; and

(g) institutions' models must be subject to periodic review to determine the accuracy of their performance, which includes assessing the continued appropriateness of assumptions, analysis of profit and loss versus risk factors, and comparison of actual close out values to model outputs.

For the purposes of sub-paragraph (d), the model must be developed or approved independently of the trading desks and be independently tested, including validation of the mathematics, assumptions and software implementation.

(8) Institutions must perform independent price verification in addition to daily marking to market or marking to model. Verification of market prices and model inputs must be performed by a person or unit independent from persons or units that benefit from the trading book, at least monthly, or more frequently depending on the nature of the market or trading activity. Where independent pricing sources are not available or pricing sources are more subjective, prudent measures such as valuation adjustments may be appropriate.

(9) Institutions must establish and maintain procedures for considering valuation adjustments.

(10) Institutions must formally consider the following valuation adjustments– unearned credit spreads, close-out costs, operational risks, market price uncertainty, early termination, investing and funding costs, future administrative costs and, where relevant, model risk.

(11) Institutions must establish and maintain procedures for calculating an adjustment to the current valuation of any less liquid positions, which can in particular arise from market events

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

or institution-related situations such as concentrated positions and/or positions for which the originally intended holding period has been exceeded. Institutions must, where necessary, make such adjustments in addition to any changes to the value of the position required for financial reporting purposes and must design such adjustments to reflect the illiquidity of the position. Under those procedures, institutions must consider several factors when determining whether a valuation adjustment is necessary for less liquid positions. Those factors include the following–

(a) the additional amount of time it would take to hedge out the position or the risks within the position beyond the liquidity horizons that have been assigned to the risk factors of the position in accordance with Article 325BD;

(b) the volatility and average of bid/offer spreads;

(c) the availability of market quotes (number and identity of market makers) and the volatility and average of trading volumes including trading volumes during periods of market stress;

(d) market concentrations;

(e) the ageing of positions;

(f) the extent to which valuation relies on marking-to-model;

(g) the impact of other model risks.

(12) When using third party valuations or marking to model, institutions must consider whether to apply a valuation adjustment. In addition, institutions must consider the need to establish adjustments for less liquid positions and on an ongoing basis review their continued suitability. Institutions must also explicitly assess the need for valuation adjustments relating to the uncertainty of parameter inputs used by models.

(13) With regard to complex products, including securitisation exposures and n-th-to-default credit derivatives, institutions must explicitly assess the need for valuation adjustments to reflect the model risk associated with using a possibly incorrect valuation methodology and the model risk associated with using unobservable (and possibly incorrect) calibration parameters in the valuation model.

TITLE 2
CAPITAL REQUIREMENTS FOR CREDIT RISK

CHAPTER 1

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

GENERAL PRINCIPLES

Internal Hedges.

106.(1) An internal hedge must in particular meet the following requirements–

(a) it must not be primarily intended to avoid or reduce own funds requirements;

(b) it must be properly documented and subject to particular internal approval and audit procedures;

(c) it must be dealt with at market conditions;

(d) the market risk that is generated by the internal hedge must be dynamically managed in the trading book within the authorised limits;

(e) it must be carefully monitored in accordance with adequate procedures.

(2) The requirements set out in paragraph (1) must apply without prejudice to the requirements applicable to the hedged position in the non-trading book or in the trading book, where relevant.

(3) Where an institution hedges a non-trading book credit risk exposure or counterparty risk exposure using a credit derivative booked in its trading book, that credit derivative position must be recognised as an internal hedge of the non-trading book credit risk exposure or counterparty risk exposure for the purpose of calculating the risk-weighted exposure amounts referred to in Article 92(3)(a) where the institution enters into another credit derivative transaction with an eligible third party protection provider that meets the requirements for unfunded credit protection in the non-trading book and perfectly offsets the market risk of the internal hedge.

Both an internal hedge recognised in accordance with the first sub-paragraph and the credit derivative entered into with the third party must be included in the trading book for the purpose of calculating the own funds requirements for market risk; and

(4) Where an institution hedges a non-trading book equity risk exposure using an equity derivative booked in its trading book, that equity derivative position must be recognised as an internal hedge of the non-trading book equity risk exposure for the purpose of calculating the risk-weighted exposure amounts referred to in Article 92(3)(a) where the institution enters into another equity derivative transaction with an eligible third party protection provider that meets the requirements for unfunded credit protection in the non- trading book and perfectly offsets the market risk of the internal hedge.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Both an internal hedge recognised in accordance with the first sub-paragraph and the equity derivative entered into with the eligible third party protection provider must be included in the trading book for the purpose of calculating the own funds requirements for market risk.

(5) Where an institution hedges non-trading book interest rate risk exposures using an interest rate risk position booked in its trading book, that interest rate risk position must be considered to be an internal hedge for the purpose of assessing the interest rate risk arising from non-trading positions in accordance with regulations 41 and 55 of the CICR Regulations where the following conditions are met–

(a) the position has been assigned to a separate portfolio from the other trading book position, the business strategy of which is solely dedicated to manage and mitigate the market risk of internal hedges of interest rate risk exposure; for that purpose, the institution may assign to that portfolio other interest rate risk positions entered into with third parties, or its own trading book as long as the institution perfectly offsets the market risk of those interest rate risk positions entered into with its own trading book by entering into opposite interest rate risk positions with third parties;

(b) for the purposes of the reporting requirements set out in Article 430B(3) (to the extent it applies on or after 1st February 2026), the position has been assigned to a trading desk established in accordance with Article 104B the business strategy of which is solely dedicated to manage and mitigate the market risk of internal hedges of interest rate risk exposure; for that purpose, that trading desk may enter into other interest rate risk positions with third parties or other trading desks of the institution, as long as those other trading desks perfectly offset the market risk of those other interest rate risk positions by entering into opposite interest rate risk positions with third parties;

(c) the institution has fully documented how the position mitigates the interest rate risk arising from non- trading book positions for the purposes of the requirements in regulations 41 and 55 of the CICR Regulations.

(6) The own funds requirements for the market risk of all the positions assigned to a separate portfolio as referred to in paragraph (5)(a) must be calculated on a stand-alone basis and be in addition to the own funds requirements for the other trading book positions.

(7) For the purposes of the reporting requirements set out in Article 430B, the calculation of the own funds requirements for market risk of all the positions assigned to the separate portfolio as referred to in paragraph (5)(a) or to the trading desk or entered into by the trading desk referred to in paragraph (5)(b), where appropriate, must be calculated on a stand-alone

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

basis as a separate portfolio and be additional to the calculation of own funds requirements for the other trading book positions.

Approaches to credit risk.

107.(1) Institutions must apply either the Standardised Approach provided for in Chapter 2 or, if permitted by the GFSC in accordance with Article 143, the Internal Ratings Based Approach provided for in Chapter 3 to calculate their risk-weighted exposure amounts for the purposes of Article 92(3)(a) and (f).

(2) For trade exposures and for default fund contributions to a central counterparty, institutions must apply the treatment set out in Articles 300 to 311 to calculate their risk-weighted exposure amounts for the purposes of Article 92(3)(a) and (f). For all other types of exposures to a central counterparty, institutions must treat those exposures as follows–

(a) as exposures to an institution for other types of exposures to a qualifying CCP;

(b) as exposures to a corporate for other types of exposures to a non-qualifying CCP.

(3) For the purposes of these Standards, exposures to a third-country investment firm, a third-country credit institution and a third-country exchange must be treated as exposures to an institution only where the third country applies prudential and supervisory requirements to that entity that are at least equivalent to those applied in Gibraltar.

(4) For the purposes of paragraph (3), the Minister may determine that a third country applies supervisory and regulatory arrangements at least equivalent to those applied in Gibraltar.

Use of credit risk mitigation technique under the Standardised Approach and the IRB Approach.

108.(1) For an exposure to which an institution applies the Standardised Approach under Chapter 2 or applies the IRB Approach under Chapter 3 but without using its own estimates of loss given default (LGD) and conversion factors under Article 151, the institution may use credit risk mitigation in accordance with Chapter 4 in the calculation of risk-weighted exposure amounts for the purposes of Article 92(3)(a) and (f) or, as relevant, expected loss amounts for the purposes of the calculation referred to in Article 36(1)(d) and Article 62(c).

(2) For an exposure to which an institution applies the IRB Approach by using their own estimates of LGD and conversion factors under Article 151, the institution may use credit risk mitigation in accordance with Chapter 3.

Treatment of securitisation positions.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

109. Institutions must calculate the risk-weighted exposure amount for a position they hold in a securitisation in accordance with Chapter 5.

Treatment of credit risk adjustment.

110.(1) Institutions applying the Standardised Approach must treat general credit risk adjustments in accordance with Article 62(c).

(2) Institutions applying the IRB Approach must treat general credit risk adjustments in accordance with Article 159, Article 62(d) and Article 36(1)(d).

For the purposes of this Article and Chapters 2 and 3, general and specific credit risk adjustments must exclude funds for general banking risk.

(3) Institutions using the IRB Approach that apply the Standardised Approach for a part of their exposures on consolidated or individual basis, in accordance with Articles 148 and 150 must determine the part of general credit risk adjustment that must be assigned to the treatment of general credit risk adjustment under the Standardised Approach and to the treatment of general credit risk adjustment under the IRB Approach as follows–

(a) where applicable, when an institution included in the consolidation exclusively applies the IRB Approach, general credit risk adjustments of this institution must be assigned to the treatment set out in paragraph (2);

(b) where applicable, when an institution included in the consolidation exclusively applies the Standardised Approach, general credit risk adjustment of this institution must be assigned to the treatment set out in paragraph (1);

(c) the remainder of credit risk adjustment must be assigned on a pro rata basis according to the proportion of risk weighted exposure amounts subject to the Standardised Approach and subject to the IRB Approach.

(4) [Not used]

CHAPTER 2
STANDARDISED APPROACH

General principles

Exposure value.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

111.(1) The exposure value of an asset item must be its accounting value remaining after specific credit risk adjustments in accordance with Article 110, additional value adjustments in accordance with Articles 34 and 105, and other own funds reductions related to the asset item have been applied. The exposure value of an off-balance sheet item listed in Schedule 1 must be the following percentage of its nominal value after reduction of specific credit risk adjustments–

(a) 100% if it is a full-risk item;

(b) 50% if it is a medium-risk item;

(c) 20% if it is a medium/low-risk item;

(d) 0% if it is a low-risk item.

The off-balance sheet items referred to in the second sentence of the first sub-paragraph must be assigned to risk categories as indicated in Schedule 1.

When an institution is using the Financial Collateral Comprehensive Method under Article 223, the exposure value of securities or commodities sold, posted or lent under a repurchase transaction or under a securities or commodities lending or borrowing transaction, and margin lending transactions must be increased by the volatility adjustment appropriate to such securities or commodities as prescribed in Articles 223 to 225.

(2) The exposure value of a derivative instrument listed in Schedule 2 must be determined in accordance with Chapter 6 with the effects of contracts of novation and other netting agreements taken into account for the purposes of those methods in accordance with Chapter 6. The exposure value of repurchase transaction, securities or commodities lending or borrowing transactions, long settlement transactions and margin lending transactions may be determined either in accordance with Chapter 6 or Chapter 4.

(3) Where an exposure is subject to funded credit protection, the exposure value applicable to that item may be amended in accordance with Chapter 4.

Exposure classes.

112. Each exposure must be assigned to one of the following exposure classes–

(a) exposures to central governments or central banks;

(b) exposures to regional governments or local authorities;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(c) exposures to public sector entities;

(d) exposures to multilateral development banks;

(e) exposures to international organisations;

(f) exposures to institutions;

(g) exposures to corporates;

(h) retail exposures;

(i) exposures secured by mortgages on immovable property;

(j) exposures in default;

(k) exposures associated with particularly high risk;

(l) exposures in the form of covered bonds;

(m) items representing securitisation positions;

(n) exposures to institutions and corporates with a short-term credit assessment;

(o) exposures in the form of units or shares in collective investment undertakings (‘CIUs’);

(p) equity exposures;

(q) other items.

Calculation of risk-weighted exposure amounts.

113.(1) To calculate risk-weighted exposure amounts, risk weights must be applied to all exposures, unless deducted from own funds, in accordance with Articles 114 to 134. The application of risk weights must be based on the exposure class to which the exposure is assigned and, to the extent specified in Articles 114 to 134, its credit quality. Credit quality may be determined by reference to the credit assessments of ECAIs or the credit assessments of export credit agencies in accordance with Articles 135 to 137.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(2) For the purposes of applying a risk weight, as referred to in paragraph (1), the exposure value must be multiplied by the risk weight specified or determined in accordance with Articles 114 to 134.

(3) Where an exposure is subject to credit protection the risk weight applicable to that item may be amended in accordance with Chapter 4.

(4) Risk-weighted exposure amounts for securitised exposures must be calculated in accordance with Chapter 5.

(5) Exposures for which no calculation is provided in Articles 114 to 134 must be assigned a risk-weight of 100%.

(6) With the exception of exposures giving rise to Common Equity Tier 1, Additional Tier 1 or Tier 2 items, an institution may, subject to the prior approval of the GFSC, decide not to apply the requirements of paragraph (1) to the exposures of that institution to a counterparty which is its parent undertaking, its subsidiary, a subsidiary of its parent undertaking or an undertaking linked by a common management relationship. The GFSC is empowered to grant approval if the following conditions are fulfilled–

(a) the counterparty is an institution, a financial institution or an ancillary services undertaking subject to appropriate prudential requirements;

(b) the counterparty is included in the same consolidation as the institution on a full basis;

(c) the counterparty is subject to the same risk evaluation, measurement and control procedures as the institution;

(d) the counterparty is established in Gibraltar;

(e) there is no current or foreseen material practical or legal impediment to the prompt transfer of own funds or repayment of liabilities from the counterparty to the institution.

Where the institution, in accordance with this paragraph, is authorised not to apply the requirements of paragraph (1), it may assign a risk weight of 0%.

Risk weights

Exposures to central governments or central banks.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

114.(1) Exposures to central governments and central banks must be assigned a 100% risk weight, unless the treatments set out in paragraphs (2) to (7) apply.

(2) Exposures to central governments and central banks for which a credit assessment by a nominated ECAI is available must be assigned a risk weight in accordance with Table 1 which corresponds to the credit assessment of the ECAI in accordance with Article 136.

Table 1

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

(3) Exposures to the ECB must be assigned a 0% risk weight.

(4) Exposures to the government of Gibraltar, the central government of the United Kingdom and the Bank of England denominated and funded in sterling must be assigned a risk weight of 0%.

(5) to (6) [Not used]

(7) When the competent authorities of a third country which apply supervisory and regulatory arrangements at least equivalent to those applied in Gibraltar assign a risk weight which is lower than that indicated in paragraphs (1) and (2) to exposures to their central government and central bank denominated and funded in the domestic currency, institutions may risk weight such exposures in the same manner.

For the purposes of this paragraph, the Minister may determine that a third country applies supervisory and regulatory arrangements at least equivalent to those applied in Gibraltar.

Exposures to regional governments or local authorities.

115.(1) Exposures to regional governments or local authorities must be risk-weighted as exposures to institutions unless they are treated as exposures to central governments under paragraphs (2) or (4) or receive a risk weight as specified in paragraph (5). The preferential treatment for short-term exposures specified in Article 119(2) and Article 120(2) must not be applied.

(2) Exposures to regional governments or local authorities must be treated as exposures to the central government in whose jurisdiction they are established where there is no difference in risk between such exposures because of the specific revenue-raising powers of the former,

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

and the existence of specific institutional arrangements the effect of which is to reduce their risk of default.

(3) Exposures to churches or religious communities constituted in the form of a legal person under public law must, in so far as they raise taxes in accordance with legislation conferring on them the right to do so, be treated as exposures to regional governments and local authorities. In this case, paragraph (2) must not apply and, for the purposes of Article 150(1)(a), approval to apply the Standardised Approach must not be excluded.

(4) When competent authorities of a third country jurisdiction which applies supervisory and regulatory arrangements at least equivalent to those applied in Gibraltar treat exposures to regional governments or local authorities as exposures to their central government and there is no difference in risk between such exposures because of the specific revenue-raising powers of regional government or local authorities and to specific institutional arrangements to reduce the risk of default, institutions may risk weight exposures to such regional governments and local authorities in the same manner.

For the purposes of this paragraph, the Minister may determine that a third country applies supervisory and regulatory arrangements at least equivalent to those applied in Gibraltar.

Exposures to public sector entities.

116.(1) Exposures to public sector entities for which a credit assessment by a nominated ECAI is not available must be assigned a risk weight in accordance with the credit quality step to which exposures to the central government of the jurisdiction in which the public sector entity is incorporated are assigned in accordance with the following Table 2–

Table 2

Credit quality step to which central government is assigned	1	2	3	4	5	6
Risk weight	20 %	50 %	100 %	100 %	100 %	150 %

For exposures to public sector entities incorporated in countries where the central government is unrated, the risk weight must be 100%.

(2) Exposures to public sector entities for which a credit assessment by a nominated ECAI is available must be treated in accordance with Article 120. The preferential treatment for short-term exposures specified in Articles 119(2) and 120(2), must not be applied to those entities.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(3) For exposures to public sector entities with an original maturity of three months or less, the risk weight must be 20%.

(4) In exceptional circumstances, exposures to public-sector entities may be treated as exposures to the central government, regional government or local authority in whose jurisdiction they are established where in the opinion of the GFSC there is no difference in risk between such exposures because of the existence of an appropriate guarantee by the central government, regional government or local authority.

(5) When competent authorities of a third country jurisdiction, which apply supervisory and regulatory arrangements at least equivalent to those applied in Gibraltar, treat exposures to public sector entities in accordance with paragraph (1) or (2), institutions may risk weight exposures to such public sector entities in the same manner. Otherwise the institutions must apply a risk weight of 100%.

For the purposes of this paragraph, the Minister may determine that a third country applies supervisory and regulatory arrangements at least equivalent to those applied in Gibraltar.

Exposures to multilateral development banks.

117.(1) Exposures to multilateral development banks that are not referred to in paragraph (2) must be treated in the same manner as exposures to institutions. The preferential treatment for short-term exposures as specified in Articles 119(2), 120(2) and 121(3) must not be applied.

The Inter-American Investment Corporation, the Black Sea Trade and Development Bank, the Central American Bank for Economic Integration and the CAF-Development Bank of Latin America must be considered multilateral development banks.

(2) Exposures to the following multilateral development banks must be assigned a 0% risk weight–

(a) the International Bank for Reconstruction and Development;

(b) the International Finance Corporation;

(c) the Inter-American Development Bank;

(d) the Asian Development Bank;

(e) the African Development Bank;

(f) the Council of Europe Development Bank;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(g) the Nordic Investment Bank;

(h) the Caribbean Development Bank;

(i) the European Bank for Reconstruction and Development;

(j) the European Investment Bank;

(k) the European Investment Fund;

(l) the Multilateral Investment Guarantee Agency;

(m) the International Finance Facility for Immunisation;

(n) the Islamic Development Bank;

(o) the International Development Association;

(p) the Asian Infrastructure Investment Bank.

Exposures to international organisations.

118. Exposures to the following international organisations must be assigned a 0% risk weight–

(a) the European Union;

(b) the International Monetary Fund;

(c) the Bank for International Settlements;

(d) the European Financial Stability Facility;

(e) the European Stability Mechanism.

Exposures to institutions.

119.(1) Exposures to institutions for which a credit assessment by a nominated ECAI is available must be risk-weighted in accordance with Article 120. Exposures to institutions for which a credit assessment by a nominated ECAI is not available must be risk-weighted in accordance with Article 121.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(2) Exposures to institutions of a residual maturity of three months or less denominated and funded in the national currency of the borrower must be assigned a risk weight that is one category less favourable than the preferential risk weight, as described in Article 114(4) to (7), assigned to exposures to the central government in which the institution is incorporated.

(3) No exposures with a residual maturity of three months or less denominated and funded in the national currency of the borrower must be assigned a risk weight less than 20%.

(4) [Not used]

(5) Exposures to financial institutions authorised and supervised by the GFSC and subject to prudential requirements comparable to those applied to institutions in terms of robustness must be treated as exposures to institutions.

(6) For the purposes of paragraph (5), the prudential requirements set out in the IFPR Regulations must be considered to be comparable to those applied to institutions in terms of robustness.

Exposures to rated institutions.

120.(1) Exposures to institutions with a residual maturity of more than three months for which a credit assessment by a nominated ECAI is available must be assigned a risk weight in accordance with Table 3 which corresponds to the credit assessment of the ECAI in accordance with Article 136.

Table 3

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

(2) Exposures to an institution of up to three months residual maturity for which a credit assessment by a nominated ECAI is available must be assigned a risk-weight in accordance with Table 4 which corresponds to the credit assessment of the ECAI in accordance with Article 136–

Table 4

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

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

(3) The interaction between the treatment of short term credit assessment under Article 131 and the general preferential treatment for short term exposures set out in paragraph (2) must be as follows–

(a) If there is no short-term exposure assessment, the general preferential treatment for short-term exposures as specified in paragraph (2) must apply to all exposures to institutions of up to three months residual maturity;

(b) If there is a short-term assessment and such an assessment determines the application of a more favourable or identical risk weight than the use of the general preferential treatment for short-term exposures, as specified in paragraph (2), then the short-term assessment must be used for that specific exposure only. Other short-term exposures must follow the general preferential treatment for short-term exposures, as specified in paragraph (2);

(c) If there is a short-term assessment and such an assessment determines a less favourable risk weight than the use of the general preferential treatment for short-term exposures, as specified in paragraph (2), then the general preferential treatment for short-term exposures must not be used and all unrated short-term claims are assigned the same risk weight as that applied by the specific short-term assessment.

Exposures to unrated institutions.

121.(1) Exposures to institutions for which a credit assessment by a nominated ECAI is not available must be assigned a risk weight in accordance with the credit quality step to which exposures to the central government of the jurisdiction in which the institution is incorporated are assigned in accordance with Table 5.

Table 5

Credit quality step to which central government is assigned	1	2	3	4	5	6
Risk weight of exposure	20 %	50 %	100 %	100 %	100 %	150 %

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(2) For exposures to unrated institutions incorporated in countries where the central government is unrated, the risk weight must be 100%.

(3) For exposures to unrated institutions with an original effective maturity of three months or less, the risk weight must be 20%.

(4) Despite paragraphs (2) and (3), for trade finance exposures referred to in the second sub-paragraph of Article 162(3)(b) to unrated institutions, the risk weight must be 50% and where the residual maturity of these trade finance exposures to unrated institutions is three months or less, the risk weight must be 20%.

Exposures to corporates.

122.(1) Exposures for which a credit assessment by a nominated ECAI is available must be assigned a risk weight in accordance with Table 6 which corresponds to the credit assessment of the ECAI in accordance with Article 136.

Table 6

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

(2) Exposures for which such a credit assessment is not available must be assigned a 100% risk weight or the risk weight of exposures to the central government of the jurisdiction in which the corporate is incorporated, whichever is the higher.

Retail exposures.

123.(1) Exposures that comply with the following criteria must be assigned a risk weight of 75%–

(a) the exposure must be either to a natural person or persons, or to a small or medium-sized enterprise (SME);

(b) the exposure must be one of a significant number of exposures with similar characteristics such that the risks associated with such lending are substantially reduced;

(c) the total amount owed to the institution and parent undertakings and its subsidiaries, including any exposure in default, by the obligor client or group of connected clients, but excluding exposures fully and completely secured on

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

residential property collateral that have been assigned to the exposure class laid down in Article 112(i), must not, to the knowledge of the institution, exceed €1 million. The institution must take reasonable steps to acquire this knowledge.

(2) Securities must not be eligible for the retail exposure class.

(3) Exposures that do not comply with the criteria referred to in sub-paragraphs (a) to (c) must not be eligible for the retail exposures class.

(4) The present value of retail minimum lease payments is eligible for the retail exposure class.

(5) Exposures due to loans granted by a credit institution to pensioners or employees with a permanent contract against the unconditional transfer of part of the borrower's pension or salary to that credit institution must be assigned a risk weight of 35% if all the following conditions are met–

(a) in order to repay the loan, the borrower unconditionally authorises the pension fund or employer to make direct payments to the credit institution by deducting the monthly payments on the loan from the borrower's monthly pension or salary;

(b) the risks of death, inability to work, unemployment or reduction of the net monthly pension or salary of the borrower are properly covered through an insurance policy underwritten by the borrower to the benefit of the credit institution;

(c) the monthly payments to be made by the borrower on all loans that meet the conditions set out in sub-paragraphs (a) and (b) do not in aggregate exceed 20% of the borrower's net monthly pension or salary;

(d) the maximum original maturity of the loan is equal to or less than ten years.

Exposures secured by mortgages on immovable property.

124.(1) An exposure or any part of an exposure fully secured by mortgage on immovable property must be assigned a risk weight of 100%, where the conditions set out in Article 125 or 126 are not met, except for any part of the exposure which is assigned to another exposure class. The part of the exposure that exceeds the mortgage value of the immovable property must be assigned the risk weight applicable to the unsecured exposures of the counterparty involved.

The part of an exposure treated as fully secured by immovable property must not be higher than the pledged amount of the market value or, if rigorous criteria are in force at the time in

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Gibraltar for the assessment of the mortgage lending value, the mortgage lending value of the property in question.

(1A) The GFSC must ensure that the Minister is informed of the GFSC's intention to make use of this Article and is appropriately involved in the assessment of financial stability concerns in Gibraltar in accordance with paragraph (2).

(2) Based on the data collected under Article 430A and on any other relevant indicators, the GFSC must periodically, and at least annually, assess whether the risk weight of 35% for exposures to one or more property segments secured by mortgages on residential property referred to in Article 125 located in Gibraltar and the risk weight of 50% for exposures secured by mortgages on commercial immovable property referred to in Article 126 located in one Gibraltar are appropriately based on–

(a) the loss experience of exposures secured by immovable property;

(b) forward-looking immovable property markets developments.

Where, on the basis of the assessment referred to in the first sub-paragraph, the GFSC concludes that the risk weights set out in Article 125(2) or 126(2) do not adequately reflect the actual risks related to exposures to one or more property segments fully secured by mortgages on residential property or on commercial immovable property located in Gibraltar, and if it considers that the inadequacy of the risk weights could adversely affect current or future financial stability in Gibraltar, it may increase the risk weights applicable to those exposures within the ranges determined in the fourth sub-paragraph of this paragraph or impose stricter criteria than those set out in Article 125(2) or 126(2).

For the purposes of the second sub-paragraph, the GFSC may set the risk weights within the following ranges–

(a) 35% to 150% for exposures secured by mortgages on residential property;

(b) 50% to 150% for exposures secured by mortgages on commercial immovable property.

(3) Where the GFSC sets higher risk weights or stricter criteria pursuant to the second sub-paragraph of paragraph (2), institutions must have a six-month transitional period to apply them.

(4) [Not used]

Exposures fully and completely secured by mortgages on residential property.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

125.(1) Unless otherwise decided by the GFSC in accordance with Article 124(2), exposures fully and completely secured by mortgages on residential property must be treated as follows–

(a) exposures or any part of an exposure fully and completely secured by mortgages on residential property which is or must be occupied or let by the owner, or the beneficial owner in the case of personal investment companies, must be assigned a risk weight of 35%;

(b) exposures to a tenant under a property leasing transaction concerning residential property under which the institution is the lessor and the tenant has an option to purchase, must be assigned a risk weight of 35% if the exposure of the institution is fully and completely secured by its ownership of the property.

(2) Institutions must consider an exposure or any part of an exposure as fully and completely secured for the purposes of paragraph (1) only if the following conditions are met–

(a) the value of the property must not materially depend upon the credit quality of the borrower. Institutions may exclude situations where purely macro-economic factors affect both the value of the property and the performance of the borrower from their determination of the materiality of such dependence;

(b) the risk of the borrower must not materially depend upon the performance of the underlying property or project, but on the underlying capacity of the borrower to repay the debt from other sources, and as a consequence, the repayment of the facility must not materially depend on any cash flow generated by the underlying property serving as collateral. For those other sources, institutions must determine maximum loan-to-income ratios as part of their lending policy and obtain suitable evidence of the relevant income when granting the loan;

(c) the requirements set out in Article 208 and the valuation rules set out in Article 229(1) are met;

(d) unless otherwise determined under Article 124(2), the part of the loan to which the 35% risk weight is assigned does not exceed 80% of the market value of the property in question or 80% of the mortgage lending value of the property in question if rigorous criteria are in force at the time in Gibraltar for the assessment of the mortgage lending value.

(3) Institutions may derogate from paragraph (2)(b) for exposures fully and completely secured by mortgages on residential property which is situated in Gibraltar, where the GFSC has determined that loss rates do not exceed the following limits–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) losses stemming from lending collateralised by residential property up to 80% of the market value or 80% of the mortgage lending value, unless otherwise decided under Article 124(2), do not exceed 0.3% of the outstanding loans collateralised by residential property in any given year;

(b) overall losses stemming from lending collateralised by residential property do not exceed 0.5% of the outstanding loans collateralised by residential property in any given year.

(4) Where either of the limits referred to in paragraph (3) is not satisfied in a given year, the eligibility to use paragraph (3) must cease and the condition contained in paragraph (2)(b) applies until the conditions in paragraph (3) are satisfied in a subsequent year.

Exposures fully and completely secured by mortgages on commercial immovable property.

126.(1) Unless otherwise decided by the GFSC in accordance with Article 124(2), exposures fully and completely secured by mortgages on commercial immovable property must be treated as follows–

(a) exposures or any part of an exposure fully and completely secured by mortgages on offices or other commercial premises may be assigned a risk weight of 50%;

(b) exposures related to property leasing transactions concerning offices or other commercial premises under which the institution is the lessor and the tenant has an option to purchase may be assigned a risk weight of 50% if the exposure of the institution is fully and completely secured by its ownership of the property.

(2) Institutions must consider an exposure or any part of an exposure as fully and completely secured for the purposes of paragraph (1) only if the following conditions are met–

(a) the value of the property must not materially depend upon the credit quality of the borrower. Institutions may exclude situations where purely macro-economic factors affect both the value of the property and the performance of the borrower from their determination of the materiality of such dependence;

(b) the risk of the borrower must not materially depend upon the performance of the underlying property or project, but on the underlying capacity of the borrower to repay the debt from other sources, and as a consequence, the repayment of the facility must not materially depend on any cash flow generated by the underlying property serving as collateral;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(c) the requirements set out in Article 208 and the valuation rules set out in Article 229(1) are met;

(d) the 50% risk weight unless otherwise provided under Article 124(2) must be assigned to the part of the loan that does not exceed 50% of the market value of the property or 60% of the mortgage lending value unless otherwise provided under Article 124(2) of the property in question if rigorous criteria are in force at the time in Gibraltar for the assessment of the mortgage lending value.

(3) Institutions may derogate from paragraph (2)(b) for exposures fully and completely secured by mortgages on commercial immovable property which is situated in Gibraltar, where the GFSC has determined that loss rates do not exceed the following limits–

(a) losses stemming from lending collateralised by commercial immovable property up to 50% of the market value or 60% of the mortgage lending value, unless otherwise determined under Article 124(2), do not exceed 0.3% of the outstanding loans collateralised by commercial immovable property;

(b) overall losses stemming from lending collateralised by commercial immovable property do not exceed 0.5% of the outstanding loans collateralised by commercial immovable property.

(4) Where either of the limits referred to in paragraph (3) is not satisfied in a given year, the eligibility to use paragraph (3) must cease and the condition contained in paragraph (2)(b) applies until the conditions in paragraph (3) are satisfied in a subsequent year.

Exposures in default.

127.(1) The unsecured part of any item where the obligor has defaulted in accordance with Article 178, or in the case of retail exposures, the unsecured part of any credit facility which has defaulted in accordance with Article 178 must be assigned a risk weight of–

(a) 150%, where the sum of specific credit risk adjustments is less than 20% of the unsecured part of the exposure value if those specific credit risk adjustments and deductions were not applied;

(b) 100%, where the sum of the specific credit risk adjustments is no less than 20% of the unsecured part of the exposure value if those specific credit risk adjustments and deductions were not applied.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(2) For the purpose of determining the secured part of the past due item, eligible collateral and guarantees must be those eligible for credit risk mitigation purposes under Chapter 4.

(3) The exposure value remaining after specific credit risk adjustments of exposures fully and completely secured by mortgages on residential property in accordance with Article 125 must be assigned a risk weight of 100% if a default has occurred in accordance with Article 178.

(4) The exposure value remaining after specific credit risk adjustments of exposures fully and completely secured by mortgages on commercial immovable property in accordance with Article 126 must be assigned a risk weight of 100% if a default has occurred in accordance with Article 178.

Items associated with particular high risk.

128.(1) Institutions must assign a 150% risk weight to exposures that are associated with particularly high risks.

(2) For the purposes of this Article, institutions must treat any of the following exposures as exposures associated with particularly high risks–

(a) investments in venture capital firms, except where those investments are treated in accordance with Article 132;

(b) investments in private equity, except where those investments are treated in accordance with Article 132;

(c) speculative immovable property financing.

(3) When assessing whether an exposure other than exposures referred to in paragraph (2) is associated with particularly high risks, institutions must take into account the following risk characteristics–

(a) there is a high risk of loss as a result of a default of the obligor;

(b) it is impossible to assess adequately whether the exposure falls under sub-paragraph (a).

Exposures in the form of covered bonds.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

129.(1) To be eligible for the preferential treatment set out in paragraphs (4) and (5), CRR covered bonds must meet the requirements set out in paragraph (7) and must be collateralised by any of the following eligible assets–

(a) exposures to or guaranteed by the Government;

(b) exposures to or guaranteed by third country central governments, third-country central banks, multilateral development banks, international organisations that qualify for the credit quality step 1 as set out in this Chapter, and exposures to or guaranteed by third-country public sector entities, third-country regional governments or third-country local authorities that are risk weighted as exposures to institutions or central governments and central banks in accordance with Article 115(1) or (2), or Article 116(1), (2) or (4) respectively and that qualify for the credit quality step 1 as set out in this Chapter, and exposures within the meaning of this sub-paragraph that qualify as a minimum for the credit quality step 2 as set out in this Chapter, if they do not exceed 20% of the nominal amount of outstanding covered bonds of the issuing institutions;

(c) exposures to institutions that qualify for the credit quality step 1 as set out in this Chapter. The total exposure of this kind must not exceed 15% of the nominal amount of outstanding covered bonds of the issuing institution. Exposures to institutions in Gibraltar with a maturity not exceeding 100 days must not be comprised by the step 1 requirement but those institutions must as a minimum qualify for credit quality step 2 as set out in this Chapter;

(d) loans secured by residential property up to the lesser of the principal amount of the liens that are combined with any prior liens and 80% of the value of the pledged properties;

(e) [Not used]

(f) loans secured by commercial immovable property up to the lesser of the principal amount of the liens that are combined with any prior liens and 60% of the value of the pledged properties.

Loans secured by commercial immovable property are eligible where the loan to value ratio of 60% is exceeded up to a maximum level of 70% if the value of the total assets pledged as collateral for the covered bonds exceed the nominal amount outstanding on the covered bond by at least 10%, and the bondholders' claim meets the legal certainty requirements set out in Chapter 4. The bondholders' claim must take priority over all other claims on the collateral;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(g) loans secured by maritime liens on ships up to the difference between 60% of the value of the pledged ship and the value of any prior maritime liens.

For the purposes of sub-paragraph (c), exposures caused by transmission and management of payments of the obligors of, or liquidation proceeds in respect of, loans secured by pledged properties of the senior units or debt securities must not be comprised in calculating the limits referred to in that sub-paragraph.

The GFSC may partly waive the application of sub-paragraph (c) and allow credit quality step 2 for up to 10% of the total exposure of the nominal amount of outstanding covered bonds of the issuing institution, where significant potential concentration problems in Gibraltar can be documented due to the application of the credit quality step 1 requirement referred to in that sub-paragraph.

(2) The situations referred to in paragraph (1)(a) to (f) must also include collateral that is exclusively restricted by legislation to the protection of the bond-holders against losses.

(3) Institutions must for immovable property collateralising CRR covered bonds meet the requirements set out in Article 208 and the valuation rules set out in Article 229(1).

(4) CRR covered bonds for which a credit assessment by a nominated ECAI is available must be assigned a risk weight in accordance with Table 6a which corresponds to the credit assessment of the ECAI in accordance with Article 136.

Table 6a

Credit quality step	1	2	3	4	5	6
Risk weight	10 %	20 %	20 %	50 %	50 %	100 %

(5) CRR covered bonds for which a credit assessment by a nominated ECAI is not available must be assigned a risk weight on the basis of the risk weight assigned to senior unsecured exposures to the institution which issues them. The following correspondence between risk weights must apply–

(a) if the exposures to the institution are assigned a risk weight of 20%, the CRR covered bond must be assigned a risk weight of 10%;

(b) if the exposures to the institution are assigned a risk weight of 50%, the CRR covered bond must be assigned a risk weight of 20%;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(c) if the exposures to the institution are assigned a risk weight of 100%, the CRR covered bond must be assigned a risk weight of 50%;

(d) if the exposures to the institution are assigned a risk weight of 150%, the CRR covered bond must be assigned a risk weight of 100%.

(6) CRR covered bonds issued before 31 December 2007 are not subject to the requirements of paragraphs (1) and (3). They are eligible for the preferential treatment under paragraphs (4) and (5) until their maturity.

(7) Exposures in the form of CRR covered bonds are eligible for preferential treatment, where the institution investing in the CRR covered bonds can demonstrate to the GFSC that–

(a) it receives portfolio information at least on–

(i) the value of the cover pool and outstanding CRR covered bonds;

(ii) the geographical distribution and type of cover assets, loan size, interest rate and currency risks;

(iii) the maturity structure of cover assets and CRR covered bonds; and

(iv) the percentage of loans more than 90 days past due;

(b) the issuer makes the information referred to in sub-paragraph (a) available to the institution at least semi-annually.

Items representing securitisation positions.

130. Risk-weighted exposure amounts for securitisation positions must be determined in accordance with Chapter 5.

Exposures to institutions and corporates with a short-term credit assessment.

131. Exposures to institutions and exposures to corporates for which a short-term credit assessment by a nominated ECAI is available must be assigned a risk weight in accordance with Table 7 which corresponds to the credit assessment of the ECAI in accordance with Article 136.

Table 7

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Credit Quality Step	1	2	3	4	5	6
Risk weight	20 %	50 %	100 %	150 %	150 %	150 %

Own funds requirements for exposures in the form of units or shares in CIUs.

132.(1) Institutions must calculate the risk-weighted exposure amount for their exposures in the form of units or shares in a CIU by multiplying the risk-weighted exposure amount of the CIU's exposures, calculated in accordance with the approaches referred to in the first sub-paragraph of paragraph (2), with the percentage of units or shares held by those institutions.

(2) Where the conditions set out in paragraph (3) are met, institutions may apply the look-through approach in accordance with Article 132A(1) or the mandate-based approach in accordance with Article 132A(2).

Subject to Article 132B(2), institutions that do not apply the look-through approach or the mandate-based approach must assign a risk weight of 1,250% ("fall-back approach") to their exposures in the form of units or shares in a CIU.

Institutions may calculate the risk-weighted exposure amount for their exposures in the form of units or shares in a CIU by using a combination of the approaches referred to in this paragraph where the conditions for using those approaches are met.

(3) Institutions may determine the risk-weighted exposure amount of a CIU's exposures in accordance with the approaches set out in Article 132A where all the following conditions are met–

(a) the CIU's prospectus or equivalent document includes the following–

(i) the categories of assets in which the CIU is authorised to invest;

(ii) where investment limits apply, the relative limits and the methodologies to calculate them;

(b) reporting by the CIU or the CIU management company to the institution complies with the following requirements–

(i) the exposures of the CIU are reported at least quarterly;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(ii) the granularity of the financial information is sufficient to allow the institution to calculate the CIU's risk-weighted exposure amount in accordance with the approach chosen by the institution;

(iii) where the institution applies the look-through approach, information about the underlying exposures is verified by an independent third party.

By way of derogation from sub-paragraph (b)(i), where the institution determines the risk-weighted exposure amount of a CIU's exposures in accordance with the mandate-based approach, the reporting by the CIU or the CIU management company to the institution may be limited to the investment mandate of the CIU and any changes thereof and may be done only when the institution incurs the exposure to the CIU for the first time and when there is a change in the investment mandate of the CIU.

(4) Institutions that do not have adequate data or information to calculate the risk-weighted exposure amount of a CIU's exposures in accordance with the approaches set out in Article 132A may rely on the calculations of a third party where all the following conditions are met–

(a) the third party is one of the following–

(i) the depository institution or the depository financial institution of the CIU, if the CIU exclusively invests in securities and deposits all securities at that depository institution or depository financial institution;

(ii) for CIUs not covered by paragraph (i), the CIU management company, if the company meets the condition set out in paragraph (3)(a);

(b) the third party carries out the calculation in accordance with the approaches set out in Article 132A(1), (2) or (3), as applicable;

(c) an external auditor has confirmed the correctness of the third party's calculation.

Institutions that rely on third-party calculations must multiply the risk-weighted exposure amount of a CIU's exposures resulting from those calculations by a factor of 1.2.

By way of derogation from the second sub-paragraph, where the institution has unrestricted access to the detailed calculations carried out by the third party, the factor of 1.2 does not apply. The institution must provide those calculations to the GFSC upon request.

(5) Where an institution applies the approaches referred to in Article 132A for the purpose of calculating the risk-weighted exposure amount of a CIU's exposures ("level 1 CIU"), and any of the underlying exposures of the level 1 CIU is an exposure in the form of units or shares

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

in another CIU ("level 2 CIU"), the risk-weighted exposure amount of the level 2 CIU's exposures may be calculated by using any of the three approaches described in paragraph (2). The institution may use the look-through approach to calculate the risk-weighted exposure amounts of CIUs' exposures in level 3 and any subsequent level only where it used that approach for the calculation in the preceding level. In any other scenario it must use the fall-back approach.

(6) The risk-weighted exposure amount of a CIU's exposures calculated in accordance with the look-through approach and the mandate-based approach set out in Article 132A(1) and (2) must be capped at the risk-weighted amount of that CIU's exposures calculated in accordance with the fall-back approach.

(7) By way of derogation from paragraph (1), institutions that apply the look-through approach in accordance with Article 132A(1) may calculate the risk-weighted exposure amount for their exposures in the form of units or shares in a CIU by multiplying the exposure values of those exposures, calculated in accordance with Article 111, with the risk weight (RW*) calculated in accordance with the formula set out in Article 132C, where the following conditions are met–

(a) the institutions measure the value of their holdings of units or shares in a CIU at historical cost but measure the value of the underlying assets of the CIU at fair value if they apply the look-through approach;

(b) a change in the market value of the units or shares for which institutions measure the value at historical cost changes neither the amount of own funds of those institutions nor the exposure value associated with those holdings.

(8) An institution must notify the GFSC if either–

(a) the total risk weighted exposure amounts for all of its exposures in the form of units or shares in relevant CIUs exceed 0.5% of the institution's total risk weighted exposures for credit risk and dilution risk calculated in accordance with Title 2 of Part 3; or

(b) the total exposure values for all of its exposures in the form of units or shares in relevant CIUs exceed £500 million;

(c) in each case calculated on an individual or consolidated basis.

(9) Institutions must make the notification in paragraph (8) promptly if–

(a) at any time either of the thresholds in paragraph (8)(a) or (b) is reached; and

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(b) until such time as it makes a notification under paragraph (10), on an annual basis thereafter.

(10) Institutions which have made or are required to have made a notification under paragraph (8) must also notify the GFSC promptly when both the total risk weighted exposure amounts and total exposure values are below the relevant thresholds set out paragraph (8)(a) and (b).

(11) Institutions must include in the notification made under paragraph (8)–

(a) a list of the countries in which fund managers of all relevant CIUs to which it is exposed are located; and

(b) the total exposure values and total risk weighted exposure amounts in respect of its exposures in the form of units or shares in relevant CIUs for each of those countries.

Approaches for calculating risk-weighted exposure amounts of CIUs.

132A.(1) Where the conditions set out in Article 132(3) are met, institutions that have sufficient information about the individual underlying exposures of a CIU must look through to those exposures to calculate the risk-weighted exposure amount of the CIU, risk weighting all underlying exposures of the CIU as if they were directly held by those institutions.

(2) Where the conditions set out in Article 132(3) are met, institutions that do not have sufficient information about the individual underlying exposures of a CIU to use the look-through approach may calculate the risk-weighted exposure amount of those exposures in accordance with the limits set in the CIU's mandate and relevant law.

Institutions must carry out the calculations referred to in the first sub-paragraph under the assumption that the CIU first incurs exposures to the maximum extent allowed under its mandate or relevant law in the exposures attracting the highest own funds requirement and then continues incurring exposures in descending order until the maximum total exposure limit is reached, and that the CIU applies leverage to the maximum extent allowed under its mandate or relevant law, where applicable.

Institutions must carry out the calculations referred to in the first sub-paragraph in accordance with the methods set out in this Chapter, in Chapter 5, and in Articles 274, 275 or 276 to 282.

(3) By way of derogation from Article 92(3)(d), institutions that calculate the risk-weighted exposure amount of a CIU's exposures in accordance with paragraph (1) or (2) may calculate

the own funds requirement for the credit valuation adjustment risk of derivative exposures of that CIU as an amount equal to 50% of the own funds requirement for those derivative exposures calculated in accordance with Articles 274, 275 or 276 to 282, as applicable.

By way of derogation from the first sub-paragraph, an institution may exclude from the calculation of the own funds requirement for credit valuation adjustment risk derivative exposures which would not be subject to that requirement if they were incurred directly by the institution.

(4) Where institutions calculate the risk-weighted exposure amount of a CIU's exposures in accordance with paragraph (2), and where one or more of the inputs required for the calculation in Articles 274, 275 or 276 to 282. is not available, institutions must carry out the calculation as follows–

Where the replacement cost is unknown, institutions must set the replacement cost as referred to in Articles 274(2) and 282(2) equal to the sum of the notional amounts of the derivatives in the netting set, and where relevant the multiplier referred to in Article 278(1) must be set equal to 1.

Where the potential future exposure is unknown, institutions must set the potential future exposure as referred to in Articles 274(2) and 282(2) equal to 15% of the sum of the notional amounts of the derivatives in the netting set.

Exclusions from the approaches for calculating risk-weighted exposure amounts of CIUs.

132B.(1) Institutions may exclude from the calculations referred to in Article 132 Common Equity Tier 1, Additional Tier 1, Tier 2 instruments and eligible liabilities instruments held by a CIU which institutions must deduct in accordance with Article 36(1) and Articles 56, 66 and 72E respectively.

(2) Institutions may exclude from the calculations referred to in Article 132 exposures in the form of units or shares in CIUs referred to in Article 150(1)(g) and (h) and instead apply the treatment set out in Article 133 to those exposures.

Treatment of off-balance-sheet exposures to CIUs.

132C. Institutions must calculate the risk-weighted exposure amount for their off-balance-sheet items with the potential to be converted into exposures in the form of units or shares in a CIU by multiplying the exposure values of those exposures calculated in accordance with Article 111, with the following risk weight–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) for all exposures for which institutions use one of the approaches set out in Article 132A–

$$RW_i^* = \frac{RWAE_i}{E_i^*} \cdot \frac{A_i}{EQ_i}$$

where–

RW*i = the risk weight;

i = the index denoting the CIU;

RWAEi = the amount calculated in accordance with Article 132A for a CIUi;

E*i = the exposure value of the exposures of CIUi;

Ai = the accounting value of assets of CIUi; and

EQi = the accounting value of the equity of CIUi;

(b) for all other exposures, RW*i = 1,250%.

Equity exposures.

133.(1) The following exposures must be considered equity exposures–

(a) non-debt exposures conveying a subordinated, residual claim on the assets or income of the issuer;

(b) debt exposures and other securities, partnerships, derivatives, or other vehicles, the economic substance of which is similar to the exposures specified in sub-paragraph (a).

(2) Equity exposures must be assigned a risk weight of 100%, unless they are required to be deducted in accordance with Part 2, assigned a 250% risk weight in accordance with Article 48(4), assigned a 1,250% risk weight in accordance with Article 89(3) or treated as high risk items in accordance with Article 128.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(3) Investments in equity or regulatory capital instruments issued by institutions must be classified as equity claims, unless deducted from own funds or attracting a 250% risk weight under Article 48(4) or treated as high risk items in accordance with Article 128.

Other items.

134.(1) Tangible assets within the meaning of item 10 of the balance sheet format specified in Part 2 of the Financial Services (Credit Institutions) (Accounts) Regulations 2021 must be assigned a risk weight of 100%.

(2) Prepayments and accrued income for which an institution is unable to determine the counterparty in accordance with the Financial Services (Credit Institutions) (Accounts) Regulations 2021, must be assigned a risk weight of 100%.

(3) Cash items in the process of collection must be assigned a 20% risk weight. Cash in hand and equivalent cash items must be assigned a 0% risk weight.

(4) Gold bullion held in own vaults or on an allocated basis to the extent backed by bullion liabilities must be assigned a 0% risk weight.

(5) In the case of asset sale and repurchase agreements and outright forward purchases, the risk weight must be that assigned to the assets in question and not to the counterparties to the transactions.

(6) Where an institution provides credit protection for a number of exposures subject to the condition that the nth default among the exposures must trigger payment and that this credit event must terminate the contract, the risk weights of the exposures included in the basket will be aggregated, excluding n-1 exposures, up to a maximum of 1,250% and multiplied by the nominal amount of the protection provided by the credit derivative to obtain the risk-weighted exposure amount. The n-1 exposures to be excluded from the aggregation must be determined on the basis that they must include those exposures each of which produces a lower risk-weighted exposure amount than the risk-weighted exposure amount of any of the exposures included in the aggregation.

(7) The exposure value for leases must be the discounted minimum lease payments. Minimum lease payments are the payments over the lease term that the lessee is or can be required to make and any bargain option the exercise of which is reasonably certain. A party other than the lessee may be required to make a payment related to the residual value of a leased property and that payment obligation fulfils the set of conditions in Article 201 regarding the eligibility of protection providers as well as the requirements for recognising other types of guarantees provided in Articles 213 to 215, that payment obligation may be taken into account as unfunded credit protection under Chapter 4. These exposures must be

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

assigned to the relevant exposure class in accordance with Article 112. When the exposure is a residual value of leased assets, the risk-weighted exposure amounts must be calculated as follows– 1/t * 100% * residual value, where t is the greater of 1 and the nearest number of whole years of the lease remaining.

Recognition and mapping of credit risk assessment

Use of credit assessments by ECAIs.

135.(1) An external credit assessment may be used to determine the risk weight of an exposure under this Chapter only if it has been issued by an ECAI or has been endorsed by an ECAI in accordance with the CRA Regulation.

(2) The GFSC must publish the list of ECAIs on its website.

136. [Not used]

Use of credit assessments by export credit agencies.

137.(1) For the purpose of Article 114, institutions may use credit assessments of an Export Credit Agency that the institution has nominated, if either of the following conditions is met–

(a) it is a consensus risk score from export credit agencies participating in the OECD ‘Arrangement on Guidelines for Officially Supported Export Credits’;

(b) the Export Credit Agency publishes its credit assessments, and the Export Credit Agency subscribes to the OECD agreed methodology, and the credit assessment is associated with one of the eight minimum export insurance premiums that the OECD agreed methodology establishes. An institution may revoke its nomination of an Export Credit Agency. An institution must substantiate the revocation if there are concrete indications that the intention underlying the revocation is to reduce the capital adequacy requirements.

(2) Exposures for which a credit assessment by an Export Credit Agency is recognised for risk weighting purposes must be assigned a risk weight in accordance with Table 9.

Table 9

MEIP	0	1	2	3	4	5	6	7
Risk weight	0 %	0 %	20 %	50 %	100 %	100 %	100 %	150 %

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

General requirements.

138. An institution may nominate one or more ECAIs to be used for the determination of risk weights to be assigned to assets and off-balance sheet items. An institution may revoke its nomination of an ECAI. An institution must substantiate the revocation if there are concrete indications that the intention underlying the revocation is to reduce the capital adequacy requirements. Credit assessments must not be used selectively. An institution must use solicited credit assessments. However it may use unsolicited credit assessments if the GFSC has confirmed that unsolicited credit assessments of an ECAI do not differ in quality from solicited credit assessments of this ECAI. The GFSC must refuse or revoke this confirmation in particular if the ECAI has used an unsolicited credit assessment to put pressure on the rated entity to place an order for a credit assessment or other services. In using credit assessment, institutions must comply with the following requirements–

(a) an institution which decides to use the credit assessments produced by an ECAI for a certain class of items must use those credit assessments consistently for all exposures belonging to that class;

(b) an institution which decides to use the credit assessments produced by an ECAI must use them in a continuous and consistent way over time;

(c) an institution must only use ECAIs credit assessments that take into account all amounts both in principal and in interest owed to it;

(d) where only one credit assessment is available from a nominated ECAI for a rated item, that credit assessment must be used to determine the risk weight for that item;

(e) where two credit assessments are available from nominated ECAIs and the two correspond to different risk weights for a rated item, the higher risk weight must be assigned;

(f) where more than two credit assessments are available from nominated ECAIs for a rated item, the two assessments generating the two lowest risk weights must be referred to. If the two lowest risk weights are different, the higher risk weight must be assigned. If the two lowest risk weights are the same, that risk weight must be assigned.

Issuer and issue credit assessment.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

139.(1) Where a credit assessment exists for a specific issuing programme or facility to which the item constituting the exposure belongs, this credit assessment must be used to determine the risk weight to be assigned to that item.

(2) Where no directly applicable credit assessment exists for a certain item, but a credit assessment exists for a specific issuing programme or facility to which the item constituting the exposure does not belong or a general credit assessment exists for the issuer, then that credit assessment must be used in either of the following cases–

(a) it produces a higher risk weight than would otherwise be the case and the exposure in question ranks *pari passu* or junior in all respects to the specific issuing program or facility or to senior unsecured exposures of that issuer, as relevant;

(b) it produces a lower risk weight and the exposure in question ranks *pari passu* or senior in all respects to the specific issuing programme or facility or to senior unsecured exposures of that issuer, as relevant.

In all other cases, the exposure must be treated as unrated.

(3) Paragraphs (1) and (2) are not to prevent the application of Article 129.

(4) Credit assessments for issuers within a corporate group cannot be used as credit assessment of another issuer within the same corporate group.

Long-term and short-term credit assessments.

140.(1) Short-term credit assessments may only be used for short-term asset and off-balance sheet items constituting exposures to institutions and corporates.

(2) Any short-term credit assessment must only apply to the item the short-term credit assessment refers to, and it must not be used to derive risk weights for any other item, except in the following cases–

(a) if a short-term rated facility is assigned a 150% risk weight, then all unrated unsecured exposures on that obligor whether short-term or long-term must also be assigned a 150% risk weight;

(b) if a short-term rated facility is assigned a 50% risk-weight, no unrated short-term exposure must be assigned a risk weight lower than 100%.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Domestic and foreign currency items.

141. A credit assessment that refers to an item denominated in the obligor's domestic currency cannot be used to derive a risk weight for another exposure on that same obligor that is denominated in a foreign currency.

When an exposure arises through an institution's participation in a loan that has been extended by a multilateral development bank whose preferred creditor status is recognised in the market, the credit assessment on the obligors' domestic currency item may be used for risk weighting purposes.

CHAPTER 3
INTERNAL RATINGS BASED APPROACH

Definitions.

142. In this Chapter–

"business unit" means any separate organisational or legal entities, business lines, geographical locations;

"facility grade" means a risk category within a rating system's facility scale, to which exposures are assigned on the basis of a specified and distinct set of rating criteria, from which own estimates of LGD are derived;

"large financial sector entity" means any financial sector entity which meets the following conditions–

(a) its total assets, calculated on an individual or consolidated basis, are greater than or equal to a €70 billion threshold, using the most recent audited financial statement or consolidated financial statement in order to determine asset size; and

(b) it is, or one of its subsidiaries is, subject to prudential regulation in Gibraltar or to the laws of a third country which applies prudential supervisory and regulatory requirements which the Minister has determined are at least equivalent to those applied in Gibraltar;

"obligor grade" means a risk category within the obligor rating scale of a rating system, to which obligors are assigned on the basis of a specified and distinct set of rating criteria, from which estimates of probability of default (PD) are derived;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

"rating system" means all of the methods, processes, controls, data collection and IT systems that support the assessment of credit risk, the assignment of exposures to rating grades or pools, and the quantification of default and loss estimates that have been developed for a certain type of exposures;

"type of exposures" means a group of homogeneously managed exposures which are formed by a certain type of facilities and which may be limited to a single entity or a single sub-set of entities within a group if the same type of exposures is managed differently in other entities of the group;

"unregulated financial sector entity" means an entity that is not a regulated financial sector entity but that performs, as its main business, one or more of the activities in the Schedule to the CICR Regulations or Parts 6 and 10 of Schedule 2 to the Act.

(2) [Not used]

Approval to use the IRB Approach.

143.(1) The GFSC may grant approval for an institution to calculate their risk-weighted exposure amounts using the Internal Ratings Based Approach (the "IRB Approach") where the GFSC considers that the conditions set out in this Chapter are met.

(2) Approval to use the IRB Approach, including own estimates of LGD and conversion factors, is required for each exposure class and for each rating system and internal models approaches to equity exposures and for each approach to estimating LGDs and conversion factors used.

(3) Institutions must obtain approval from the GFSC for the following–

(a) material changes to the range of application of a rating system or an internal models approach to equity exposures that the institution has received approval to use;

(b) material changes to a rating system or an internal models approach to equity exposures that the institution has received approval to use.

The range of application of a rating system must comprise all exposures of the relevant type of exposure for which that rating system was developed.

(4) Institutions must notify the GFSC of all changes to rating systems and internal models approaches to equity exposures.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(5) [Not used]

GFSC's assessment of an application to use an IRB Approach.

144.(1) In determining an application under Article 143 for an institution to use the IRB Approach, including to use own estimates of LGD and conversion factors, the GFSC must consider whether the requirements laid down in this Chapter are met, in particular those laid down in Article 169 to 191, and that the systems of the institution for the management and rating of credit risk exposures are sound and implemented with integrity and, in particular, that the institution has demonstrated to the satisfaction of the GFSC that the following standards are met–

(a) the institution's rating systems provide for a meaningful assessment of obligor and transaction characteristics, a meaningful differentiation of risk and accurate and consistent quantitative estimates of risk;

(b) internal ratings and default and loss estimates used in the calculation of own funds requirements and associated systems and processes play an essential role in the risk management and decision-making process, and in the credit approval, internal capital allocation and corporate governance functions of the institution;

(c) the institution has a credit risk control unit responsible for its rating systems that is appropriately independent and free from undue influence;

(d) the institution collects and stores all relevant data to provide effective support to its credit risk measurement and management process;

(e) the institution documents its rating systems and the rationale for their design and validates its rating systems;

(f) the institution has validated each rating system and each internal models approach for equity exposures during an appropriate time period prior to the approval to use this rating system or internal models approach to equity exposures, has assessed during this time period whether the rating system or internal models approaches for equity exposures are suited to the range of application of the rating system or internal models approach for equity exposures, and has made necessary changes to these rating systems or internal models approaches for equity exposures following from its assessment;

(g) the institution has calculated under the IRB Approach the own funds requirements resulting from its risk parameters estimates and is able to submit the reporting as required by Article 430;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(h) the institution has assigned and continues with assigning each exposure in the range of application of a rating system to a rating grade or pool of this rating system; the institution has assigned and continues with assigning each exposure in the range of application of an approach for equity exposures to this internal models approach.

The requirements to use an IRB Approach, including own estimates of LGD and conversion factors, apply also where an institution has implemented a rating system, or model used within a rating system, that it has purchased from a third-party vendor.

(2) [Not used]

Prior experience of using IRB approaches.

145.(1) An institution applying to use the IRB Approach must have been using for the IRB exposure classes in question rating systems that were broadly in line with the requirements set out in Articles 169 to 191 for internal risk measurement and management purposes for at least three years prior to its qualification to use the IRB Approach.

(2) An institution applying for the use of own estimates of LGDs and conversion factors must demonstrate to the satisfaction of the GFSC that it has been estimating and employing own estimates of LGDs and conversion factors in a manner that is broadly consistent with the requirements for use of own estimates of those parameters set out in 169 to 191 for at least three years prior to qualification to use own estimates of LGDs and conversion factors.

(3) Where the institution extends the use of the IRB Approach subsequent to its initial approval, the experience of the institution must be sufficient to satisfy the requirements of paragraphs (1) and (2) in respect of the additional exposures covered. If the use of rating systems is extended to exposures that are significantly different from the scope of the existing coverage, such that the existing experience cannot be reasonably assumed to be sufficient to meet the requirements of these provisions in respect of the additional exposures, then the requirements of paragraphs (1) and (2) must apply separately for the additional exposures.

Measures to be taken where the requirements of this Chapter cease to be met.

146. Where an institution ceases to comply with the requirements laid down in this Chapter, it must notify the GFSC and do one of the following–

(a) present to the satisfaction of the GFSC a plan for a timely return to compliance and realise this plan within a period agreed with the GFSC;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(b) demonstrate to the satisfaction of the GFSC that the effect of non-compliance is immaterial.

Methodology to assign exposures to exposure classes.

147.(1) The methodology used by the institution for assigning exposures to different exposure classes must be appropriate and consistent over time.

(2) Each exposure must be assigned to one of the following exposure classes–

(a) exposures to central governments and central banks;

(b) exposures to institutions;

(c) exposures to corporates;

(d) retail exposures;

(e) equity exposures;

(f) items representing securitisation positions;

(g) other non credit-obligation assets.

(3) The following exposures must be assigned to the class laid down in paragraph (2)(a)–

(a) exposures to regional governments, local authorities or public sector entities which are treated as exposures to central governments under Articles 115 and 116;

(b) exposures to multilateral development banks referred to in Article 117(2);

(c) exposures to International Organisations which attract a risk weight of 0% under Article 118.

(4) The following exposures must be assigned to the class laid down in paragraph (2)(b)–

(a) exposures to regional governments and local authorities which are not treated as exposures to central governments in accordance with Article 115(2) and (4);

(b) exposures to public sector entities which are not treated as exposures to central governments in accordance with Article 116(4);

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(c) exposures to multilateral development banks which are not assigned a 0% risk weight under Article 117; and

(d) exposures to financial institutions which are treated as exposures to institutions in accordance with Article 119(5).

(5) To be eligible for the retail exposure class laid down in paragraph (2)(d), exposures must meet the following criteria–

(a) they must be one of the following–

(i) exposures to one or more natural persons;

(ii) exposures to an SME, provided in that case that the total amount owed to the institution and parent undertakings and its subsidiaries, including any past due exposure, by the obligor client or group of connected clients, but excluding exposures secured on residential property collateral, must not, to the knowledge of the institution, which must have taken reasonable steps to confirm the situation, exceed €1 million;

(b) they are treated by the institution in its risk management consistently over time and in a similar manner;

(c) they are not managed just as individually as exposures in the corporate exposure class;

(d) they each represent one of a significant number of similarly managed exposures.

In addition to the exposures listed in the first sub-paragraph, the present value of retail minimum lease payments must be included in the retail exposure class.

(6) The following exposures must be assigned to the equity exposure class laid down in paragraph (2)(e)–

(a) non-debt exposures conveying a subordinated, residual claim on the assets or income of the issuer;

(b) debt exposures and other securities, partnerships, derivatives, or other vehicles, the economic substance of which is similar to the exposures specified in sub-paragraph (a).

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(7) Any credit obligation not assigned to the exposure classes laid down in paragraph (2)(a), (b), (d) to (f) must be assigned to the corporate exposure class referred to in paragraph (2)(c).

(8) Within the corporate exposure class laid down in paragraph (2)(c), institutions must separately identify as specialised lending exposures, exposures which possess the following characteristics–

(a) the exposure is to an entity which was created specifically to finance or operate physical assets or is an economically comparable exposure;

(b) the contractual arrangements give the lender a substantial degree of control over the assets and the income that they generate;

(c) the primary source of repayment of the obligation is the income generated by the assets being financed, rather than the independent capacity of a broader commercial enterprise.

(9) The residual value of leased properties must be assigned to the exposure class laid down in paragraph (2)(g), except to the extent that residual value is already included in the lease exposure laid down in Article 166(4).

(10) The exposure from providing protection under an nth-to-default basket credit derivative must be assigned to the same class laid down in paragraph (2) to which the exposures in the basket would be assigned, except if the individual exposures in the basket would be assigned to various exposure classes in which case the exposure must be assigned to the corporates exposure class laid down in paragraph (2)(c).

Conditions for implementing the IRB Approach across different classes of exposure and business units.

148.(1) Institutions and any parent undertaking and its subsidiaries must implement the IRB Approach for all exposures, unless they have received the approval of the GFSC to permanently use the Standardised Approach in accordance with Article 150.

Subject to GFSC approval, implementation may be carried out sequentially across the different exposure classes referred to in Article 147 within the same business unit, across different business units in the same group or for the use of own estimates of LGDs or conversion factors for the calculation of risk weights for exposures to corporates, institutions, and central governments and central banks.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

In the case of the retail exposure class referred to in Article 147(5), implementation may be carried out sequentially across the categories of exposures to which the different correlations in Article 154 correspond.

(2) The GFSC must determine the time period over which an institution and any parent undertaking and its subsidiaries must be required to implement the IRB Approach for all exposures. This time period must be one that the GFSC considers to be appropriate on the basis of the nature and scale of the activities of the institutions, or any parent undertaking and its subsidiaries, and the number and nature of rating systems to be implemented.

(3) Institutions must carry out implementation of the IRB Approach in accordance with conditions determined by the GFSC. The GFSC must design those conditions such that they ensure that the flexibility under paragraph (1) is not used selectively for the purposes of achieving reduced own funds requirements in respect of those exposure classes or business units that are yet to be included in the IRB Approach or in the use of own estimates of LGDs and conversion factors.

(4) Institutions that have begun to use the IRB Approach only after 1 January 2013 or that have until that date been required by the GFSC to be able to calculate their capital requirements using the Standardised Approach must retain their ability to calculate capital requirements using the Standardised Approach for all their exposures during the implementation period until the GFSC notifies them that they are satisfied that the implementation of the IRB Approach will be completed with reasonable certainty.

(5) An institution that is permitted to use the IRB Approach for any exposure class must use the IRB Approach for the equity exposure class laid down in Article 147(2)(e), except where that institution is permitted to apply the Standardised Approach for equity exposures pursuant to Article 150 and for the other non credit-obligation assets exposure class laid down in Article 147(2)(g).

(6) [Not used]

Conditions to revert to the use of less sophisticated approaches.

149.(1) An institution that uses the IRB Approach for a particular exposure class or type of exposure must not stop using that approach and use instead the Standardised Approach for the calculation of risk-weighted exposure amounts unless the following conditions are met–

(a) the institution has demonstrated to the satisfaction of the GFSC that the use of the Standardised Approach is not proposed in order to reduce the own funds requirement of the institution, is necessary on the basis of nature and complexity of the institution's total exposures of this type and would not have a material

adverse impact on the solvency of the institution or its ability to manage risk effectively;

(b) the institution has received GFSC approval.

(2) Institutions which have obtained approval under Article 151(9) to use own estimates of LGDs and conversion factors, must not revert to the use of LGD values and conversion factors referred to in Article 151(8) unless the following conditions are met–

(a) the institution has demonstrated to the satisfaction of the GFSC that the use of LGDs and conversion factors laid down in Article 151(8) for a certain exposure class or type of exposure is not proposed in order to reduce the own funds requirement of the institution, is necessary on the basis of nature and complexity of the institution's total exposures of this type and would not have a material adverse impact on the solvency of the institution or its ability to manage risk effectively;

(b) the institution has received GFSC approval.

(3) The application of paragraphs (1) and (2) is subject to the conditions for rolling out the IRB Approach determined by the GFSC in accordance with Article 148 and the approval for permanent partial use referred to in Article 150.

Conditions for permanent partial use.

150.(1) Where institutions have received GFSC approval, institutions permitted to use the IRB Approach in the calculation of risk-weighted exposure amounts and expected loss amounts for one or more exposure classes may apply the Standardised Approach for the following exposures–

(a) the exposure class laid down in Article 147(2)(a), where the number of material counterparties is limited and it would be unduly burdensome for the institution to implement a rating system for these counterparties;

(b) the exposure class laid down in Article 147(2)(b), where the number of material counterparties is limited and it would be unduly burdensome for the institution to implement a rating system for these counterparties;

(c) exposures in non-significant business units as well as exposure classes or types of exposures that are immaterial in terms of size and perceived risk profile;

(d) exposures to the government or a public sector entity in Gibraltar if–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(i) there is no difference in risk between the exposures to the government and those other exposures because of specific public arrangements; and

(ii) exposures to the government are assigned a 0% risk weight under Article 114(2) or (4);

(e) exposures of an institution to a counterparty which is its parent undertaking, its subsidiary or a subsidiary of its parent undertaking if the counterparty is an institution or a financial holding company, mixed financial holding company, financial institution, asset management company or ancillary services undertaking subject to appropriate prudential requirements or an undertaking linked by a common management relationship;

(f) [Not used]

(g) equity exposures to entities whose credit obligations are assigned a 0% risk weight under Chapter 2 including those publicly sponsored entities where a 0% risk weight can be applied;

(h) equity exposures incurred under legislative programmes to promote specified sectors of the economy that provide significant subsidies for the investment to the institution and involve some form of government oversight and restrictions on the equity investments where such exposures may in aggregate be excluded from the IRB Approach only up to a limit of 10% of own funds;

(i) [Not used]

(j) State and State-reinsured guarantees referred to in Article 215(2).

(2) For the purposes of paragraph (1), the equity exposure class of an institution must be material if their aggregate value, excluding equity exposures incurred under legislative programmes as referred to in paragraph (1)(h), exceeds on average over the preceding year 10% of the own funds of the institution. Where the number of those equity exposures is less than 10 individual holdings, that threshold must be 5% of the own funds of the institution.

(3) [Not used]

Calculation of risk-weighted exposure amounts

Treatment by exposure class.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

151.(1) The risk-weighted exposure amounts for credit risk for exposures belonging to one of the exposure classes referred to in 147(2)(a) to (e) and (g) must, unless deducted from own funds, be calculated in accordance with Articles 153 to 156 except where those exposures are deducted from Common Equity Tier 1 items, Additional Tier 1 items or Tier 2 items.

(2) The risk-weighted exposure amounts for dilution risk for purchased receivables must be calculated in accordance with Article 157. Where an institution has full recourse to the seller of purchased receivables for default risk and for dilution risk, the provisions of this Article and Article 152 and Article 158(1) to (4) in relation to purchased receivables must not apply and the exposure must be treated as a collateralised exposure.

(3) The calculation of risk-weighted exposure amounts for credit risk and dilution risk must be based on the relevant parameters associated with the exposure in question. These must include PD, LGD, maturity (“M”) and exposure value of the exposure. PD and LGD may be considered separately or jointly, in accordance with Articles 160 to 165.

(4) Institutions must calculate risk-weighted exposure amounts for credit risk for all exposures belonging to the exposure class ‘equity’ referred to in Article 147(2)(e) in accordance with Article 155. Institutions may use the approaches set out in Article 155(3) and (4) where they have received GFSC approval. The GFSC, in determining an application for an institution to use the internal models approach set out in Article 155(4), must consider whether the institution meets the requirements set out in Articles 186 to 188.

(5) The calculation of risk weighted exposure amounts for credit risk for specialised lending exposures may be calculated in accordance with Article 153(5).

(6) For exposures belonging to the exposure classes referred to in Article 147(2)(a) to (d), institutions must provide their own estimates of PDs in accordance with Articles 143 and 169 to 191.

(7) For exposures belonging to the exposure class referred to in Article 147(2)(d), institutions must provide own estimates of LGDs and conversion factors in accordance with Articles 143 and 169 to 191.

(8) For exposures belonging to the exposure classes referred to in Article 147(2)(a) to (c), institutions must apply the LGD values set out in Article 161(1), and the conversion factors set out in Article 166(8)(a) to (d), unless it has been permitted to use its own estimates of LGDs and conversion factors for those exposure classes in accordance with paragraph (9).

(9) For all exposures belonging to the exposure classes referred to in Article 147(2)(a) to (c), the GFSC must permit institutions to use own estimates of LGDs and conversion factors in accordance with Articles 143 and 169 to 191.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(10) The risk-weighted exposure amounts for securitised exposures and for exposures belonging to the exposure class referred to in Article 147(2)(f) must be calculated in accordance with Chapter 5.

Treatment of exposures in the form of units or shares in CIUs.

152.(1) Institutions must calculate the risk-weighted exposure amounts for their exposures in the form of units or shares in a CIU by multiplying the risk-weighted exposure amount of the CIU, calculated in accordance with the approaches set out in paragraphs (2) and (5), with the percentage of units or shares held by those institutions.

(2) Where the conditions set out in Article 132(3) are met, institutions that have sufficient information about the individual underlying exposures of a CIU must look through to those underlying exposures to calculate the risk-weighted exposure amount of the CIU, risk weighting all underlying exposures of the CIU as if they were directly held by the institutions.

(3) By way of derogation from Article 92(3)(d), institutions that calculate the risk-weighted exposure amount of the CIU in accordance with paragraph (1) or (2) may calculate the own funds requirement for credit valuation adjustment risk of derivative exposures of that CIU as an amount equal to 50% of the own funds requirement for those derivative exposures calculated in accordance with Articles 274 to 282, as applicable.

By way of derogation from the first sub-paragraph, an institution may exclude from the calculation of the own funds requirement for credit valuation adjustment risk derivative exposures which would not be subject to that requirement if they were incurred directly by the institution.

(4) Institutions that apply the look-through approach in accordance with paragraphs (2) and (3) and that meet the conditions for permanent partial use in accordance with Article 150, or that do not meet the conditions for using the methods set out in this Chapter or one or more of the methods set out in Chapter 5 for all or parts of the underlying exposures of the CIU, must calculate risk-weighted exposure amounts and expected loss amounts in accordance with the following principles–

(a) for exposures assigned to the equity exposure class referred to in Article 147(2)(e), institutions must apply the simple risk-weight approach set out in Article 155(2);

(b) for exposures assigned to the items representing securitisation positions referred to in Article 147(2)(f), institutions must apply the treatment set out in Article 254 as if those exposures were directly held by those institutions;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(c) for all other underlying exposures, institutions must apply the Standardised Approach laid down in Chapter 2 of this Title.

For the purposes of sub-paragraph (a), where the institution is unable to differentiate between private equity exposures, exchange-traded exposures and other equity exposures, it must treat the exposures concerned as other equity exposures.

(5) Where the conditions set out in Article 132(3) are met, institutions that do not have sufficient information about the individual underlying exposures of a CIU may calculate the risk-weighted exposure amount for those exposures in accordance with the mandate-based approach set out in Article 132A(2). However, for the exposures listed in paragraph (4)(a) to (c), institutions must apply the approaches set out in that paragraph.

(6) Subject to Article 132B(2), institutions that do not apply the look-through approach in accordance with paragraphs (2) and (3) or the mandate-based approach in accordance with paragraph (5) must apply the fall-back approach referred to in Article 132(2).

(7) Institutions may calculate the risk-weighted exposure amount for their exposures in the form of units or shares in a CIU by using a combination of the approaches referred to in this Article where the conditions for using those approaches are met.

(8) Institutions that do not have adequate data or information to calculate the risk-weighted amount of a CIU in accordance with the approaches set out in paragraphs (2), (3), (4) and (5) may rely on the calculations of a third party where all the following conditions are met–

(a) the third party is one of the following–

(i) the depository institution or the depository financial institution of the CIU, if the CIU exclusively invests in securities and deposits all securities at that depository institution or depository financial institution; or

(ii) for CIUs not covered by paragraph (i), the CIU management company;

(b) for exposures other than those listed in paragraph (4)(a) to (c), the third party carries out the calculation in accordance with the look-through approach set out in Article 132A(1);

(c) for exposures listed in paragraph (4)(a) to (c), the third party carries out the calculation in accordance with the approaches set out in that paragraph; and

(d) an external auditor has confirmed the correctness of the third party's calculation.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Institutions that rely on third-party calculations must multiply the risk-weighted exposure amounts of a CIU's exposures resulting from those calculations by a factor of 1.2.

By way of derogation from the second sub-paragraph, where the institution has unrestricted access to the detailed calculations carried out by the third party, the 1.2 factor must not apply. The institution must provide those calculations to the GFSC upon request.

(9) For the purposes of this Article–

(a) Articles 132(5) and (6) and 132B apply; and

(b) Article 132C must apply, using the risk weights calculated in accordance with Chapter 3 of this Title.

Risk-weighted exposure amounts for exposures to corporates, institutions and central governments and central banks.

153.(1) Subject to the application of the specific treatments laid down in paragraphs (2), (3) and (4), the risk-weighted exposure amounts for exposures to corporates, institutions and central governments and central banks must be calculated according to the following formulae–

Risk – weighted exposure amount = RW · exposure value

where the risk weight RW is defined as–

(i) if PD = 0, RW is 0;

(ii) if PD = 1, i.e., for defaulted exposures–

where institutions apply the LGD values set out in Article 161(1), RW is 0;

where institutions use own estimates of LGDs, RW is–

$$RW = \max\{0, 12.5 \cdot (LGD - EL_{BE})\}$$

where the expected loss best estimate (hereinafter referred to as 'EL BE ') is the institution's best estimate of expected loss for the defaulted exposure in accordance with Article 181(1)(h);

(iii) if 0 < PD < 1

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

$$RW = \left(LGD \cdot N\left(\frac{1}{\sqrt{1-R}} \cdot G(PD) + \sqrt{\frac{R}{1-R}} \cdot G(0.999)\right) - LGD \cdot PD\right) \cdot \frac{1 + (M - 2{,}5) \cdot b}{1 - 1{,}5 \cdot b} \cdot 12{,}5 \cdot 1{,}06$$

where–

N(x) = the cumulative distribution function for a standard normal random variable (i.e. the probability that a normal random variable with mean zero and variance of one is less than or equal to x);

G(Z) = denotes the inverse cumulative distribution function for a standard normal random variable (i.e. the value x such that N(x) = z)

R = denotes the coefficient of correlation, is defined as

$$R = 0.12 \cdot \frac{1 - e^{-50 \cdot PD}}{1 - e^{-50}} + 0.24 \cdot \left(1 - \frac{1 - e^{-50 \cdot PD}}{1 - e^{-50}}\right)$$

b = the maturity adjustment factor, which is defined as

$$b = (0.11852 - 0.05478 \cdot \ln(PD))^2$$

(2) For all exposures to large financial sector entities, the co-efficient of correlation of paragraph (1)(iii) is multiplied by 1.25. For all exposures to unregulated financial sector entities, the coefficients of correlation set out in paragraph (1)(iii) and paragraph (4), as relevant, are multiplied by 1.25.

(3) The risk-weighted exposure amount for each exposure which meets the requirements set out in Articles 202 and 217 may be adjusted in accordance with the following formula–

Risk – weighted exposure amount = RW · exposure value · (0.15 + 160 · PD pp)

where–

PD pp = PD of the protection provider.

RW is calculated using the relevant risk weight formula set out in paragraph (1) for the exposure, the PD of the obligor and the LGD of a comparable direct exposure to the protection provider. The maturity factor (b) must be calculated using the lower of the PD of the protection provider and the PD of the obligor.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(4) For exposures to companies where the total annual sales for the consolidated group of which the firm is a part is less than €50 million, institutions may use the following correlation formula in paragraph (1)(iii) for the calculation of risk weights for corporate exposures. In this formula S is expressed as total annual sales in millions of euro with €5 million ≤ S ≤ €50 million. Reported sales of less than €5 million must be treated as if they were equivalent to €5 million. For purchased receivables the total annual sales must be the weighted average by individual exposures of the pool.

$$R = 0.12 \cdot \frac{1 - e^{-50 \cdot PD}}{1 - e^{-50}} + 0.24 \cdot \left(1 - \frac{1 - e^{-50 \cdot PD}}{1 - e^{-50}}\right) - 0.04 \cdot \left(1 - \frac{\min\{\max\{5,S\},50\} - 5}{45}\right)$$

Institutions must substitute total assets of the consolidated group for total annual sales when total annual sales are not a meaningful indicator of firm size and total assets are a more meaningful indicator than total annual sales.

(5) For specialised lending exposures in respect of which an institution is not able to estimate PDs or the institutions' PD estimates do not meet the requirements set out in Articles 169 to 191, the institution must assign risk weights to these exposures in accordance with Table 1, as follows–

Table 1

Remaining Maturity	Category 1	Category 2	Category 3	Category 4	Category 5
Less than 2,5 years	50 %	70 %	115 %	250 %	0 %
Equal or more than 2,5 years	70 %	90 %	115 %	250 %	0 %

In assigning risk weights to specialised lending exposures institutions must take into account the following factors– financial strength, political and legal environment, transaction and/or asset characteristics, strength of the sponsor and developer, including any public private partnership income stream, and security package.

(6) For their purchased corporate receivables institutions must comply with the requirements set out in Article 184. For purchased corporate receivables that comply in addition with the conditions set out in Article 154(5), and where it would be unduly burdensome for an institution to use the risk quantification standards for corporate exposures as set out in Articles 169 to 191 for these receivables, the risk quantification standards for retail exposures as set out in those Articles may be used.

(7) For purchased corporate receivables, refundable purchase price discounts, collaterals or partial guarantees that provide first loss protection for default losses, dilution losses, or both, may be treated as a first loss protection by the purchaser of the receivables or by the beneficiary

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

of the collateral or of the partial guarantee in accordance with Articles 254 to 266. The seller providing the refundable purchase price discount and the provider of a collateral or a partial guarantee must treat those as an exposure to a first loss position in accordance with Articles 254 to 266.

(8) Where an institution provides credit protection for a number of exposures subject to the condition that the nth default among the exposures must trigger payment and that this credit event must terminate the contract, the risk weights of the exposures included in the basket will be aggregated, excluding n-1 exposures, where the sum of the expected loss amount multiplied by 12.5 and the risk-weighted exposure amount must not exceed the nominal amount of the protection provided by the credit derivative multiplied by 12.5. The n-1 exposures to be excluded from the aggregation must be determined on the basis that they must include those exposures each of which produces a lower risk-weighted exposure amount than the risk-weighted exposure amount of any of the exposures included in the aggregation. A 1 250% risk weight must apply to positions in a basket for which an institution cannot determine the risk-weight under the IRB Approach.

(9) [Not used]

Risk-weighted exposure amounts for retail exposures.

154.(1) The risk-weighted exposure amounts for retail exposures must be calculated in accordance with the following formulae–

Risk – weighted exposure amount = RW · exposure value

where the risk weight RW is defined as follows–

(i) if PD = 1, i.e., for defaulted exposures, RW is

$$RW = \max \{0{,}12.5 \cdot (LGD - EL_{BE})\}$$

where EL_{BE} is the institution's best estimate of expected loss for the defaulted exposure in accordance with Article 181(1)(h);

(ii) if 0 < PD < 1, i.e., for any possible value for PD other than under (i)

$$RW = \left(LGD \cdot N\left(\frac{1}{\sqrt{1-R}} \cdot G(PD) + \sqrt{\frac{R}{1-R}} \cdot G(0.999) \right) - LGD \cdot PD \right) \cdot 12{,}5 \cdot 1{,}06$$

where–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

N(x) = the cumulative distribution function for a standard normal random variable (i.e. the probability that a normal random variable with mean zero and variance of one is less than or equal to x);

G(Z) = the inverse cumulative distribution function for a standard normal random variable (i.e. the value x such that N(x) = z);

R = the coefficient of correlation defined as

$$R = 0.03 \cdot \frac{1 - e^{-35 \cdot PD}}{1 - e^{-35}} + 0.16 \cdot \left(1 - \frac{1 - e^{-35 \cdot PD}}{1 - e^{-35}}\right)$$

(2) The risk-weighted exposure amount for each exposure to an SME as referred to in Article 147(5) which meets the requirements set out in Articles 202 and 217 may be calculated in accordance with Article 153(3).

(3) For retail exposures secured by immovable property collateral a coefficient of correlation R of 0.15 must replace the figure produced by the correlation formula in paragraph (1).

(4) For qualifying revolving retail exposures in accordance with sub-paragraphs (a) to (e), a coefficient of correlation R of 0.04 must replace the figure produced by the correlation formula in paragraph (1).

Exposures must qualify as qualifying revolving retail exposures if they meet the following conditions–

(a) the exposures are to individuals;

(b) the exposures are revolving, unsecured, and to the extent they are not drawn immediately and unconditionally, cancellable by the institution. In this context revolving exposures are defined as those where customers' outstanding balances are permitted to fluctuate based on their decisions to borrow and repay, up to a limit established by the institution. Undrawn commitments may be considered as unconditionally cancellable if the terms permit the institution to cancel them to the full extent allowable under consumer protection and related legislation;

(c) the maximum exposure to a single individual in the sub-portfolio is €100,000 or less;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(d) the use of the correlation of this paragraph is limited to portfolios that have exhibited low volatility of loss rates, relative to their average level of loss rates, especially within the low PD bands;

(e) the treatment as a qualifying revolving retail exposure must be consistent with the underlying risk characteristics of the sub-portfolio.

By way of derogation from sub-paragraph (b), the requirement to be unsecured does not apply in respect of collateralised credit facilities linked to a wage account. In this case amounts recovered from the collateral must not be taken into account in the LGD estimate.

The GFSC may review the relative volatility of loss rates across the qualifying revolving retail sub-portfolios, as well the aggregate qualifying revolving retail portfolio.

(5) To be eligible for the retail treatment, purchased receivables must comply with the requirements set out in Article 184 and the following conditions–

(a) the institution has purchased the receivables from unrelated third party sellers, and its exposure to the obligor of the receivable does not include any exposures that are directly or indirectly originated by the institution itself;

(b) the purchased receivables must be generated on an arm's-length basis between the seller and the obligor. As such, inter-company accounts receivables and receivables subject to contra-accounts between firms that buy and sell to each other are ineligible;

(c) the purchasing institution has a claim on all proceeds from the purchased receivables or a pro-rata interest in the proceeds; and

(d) the portfolio of purchased receivables is sufficiently diversified.

(6) For purchased retail receivables, refundable purchase price discounts, collaterals or partial guarantees that provide first loss protection for default losses, dilution losses, or both, may be treated as a first loss protection by the purchaser of the receivables or by the beneficiary of the collateral or of the partial guarantee in accordance with Articles 254 to 266. The seller providing the refundable purchase price discount and the provider of a collateral or a partial guarantee must treat those as an exposure to a first loss position in accordance with Articles 254 to 266.

(7) For hybrid pools of purchased retail receivables where purchasing institutions cannot separate exposures secured by immovable property collateral and qualifying revolving retail

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

exposures from other retail exposures, the retail risk weight function producing the highest capital requirements for those exposures applies.

Risk-weighted exposure amounts for equity exposures.

155.(1) Institutions must determine their risk-weighted exposure amounts for equity exposures, excluding those deducted in accordance with Part 2 or subject to a 250% risk weight in accordance with Article 48, in accordance with the approaches set out in paragraphs (2), (3) and (4). An institution may apply different approaches to different equity portfolios where the institution itself uses different approaches for internal risk management purposes. Where an institution uses different approaches, the choice of the PD/LGD approach or the internal models approach must be made consistently, including over time and with the approach used for the internal risk management of the relevant equity exposure, and must not be determined by regulatory arbitrage considerations.

Institutions may treat equity exposures to ancillary services undertakings in accordance with the treatment of other non credit- obligation assets.

(2) Under the simple risk weight approach, the risk-weighted exposure amount must be calculated in accordance with the formula–

$$\text{Risk} - \text{weighted exposure amount} = RW * \text{exposure value} ,$$

where–

Risk weight (RW) = 190% for private equity exposures in sufficiently diversified portfolios.

Risk weight (RW) = 290% for exchange traded equity exposures.

Risk weight (RW) = 370% for all other equity exposures.

Short cash positions and derivative instruments held in the non-trading book are permitted to offset long positions in the same individual stocks where these instruments have been explicitly designated as hedges of specific equity exposures and that they provide a hedge for at least another year. Other short positions are to be treated as if they are long positions with the relevant risk weight assigned to the absolute value of each position. In the context of maturity mismatched positions, the method is that for corporate exposures as set out in Article 162(5).

Institutions may recognise unfunded credit protection obtained on an equity exposure in accordance with the methods set out in Chapter 4.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(3) Under the PD/LGD approach, risk-weighted exposure amounts must be calculated according to the formulas in Article 153(1). If institutions do not have sufficient information to use the definition of default set out in Article 178, a scaling factor of 1.5 must be assigned to the risk weights.

At the individual exposure level the sum of the expected loss amount multiplied by 12.5 and the risk-weighted exposure amount must not exceed the exposure value multiplied by 12.5.

Institutions may recognise unfunded credit protection obtained on an equity exposure in accordance with the methods set out in Chapter 4. This is subject to an LGD of 90% on the exposure to the provider of the hedge. For private equity exposures in sufficiently diversified portfolios an LGD of 65% may be used. For these purposes M must be five years.

(4) Under the internal models approach, the risk-weighted exposure amount must be the potential loss on the institution's equity exposures as derived using internal value-at-risk models subject to the 99th percentile, one-tailed confidence interval of the difference between quarterly returns and an appropriate risk-free rate computed over a long-term sample period, multiplied by 12.5. The risk-weighted exposure amounts at the equity portfolio level must not be less than the total of the sums of the following–

(a) the risk-weighted exposure amounts required under the PD/LGD Approach; and

(b) the corresponding expected loss amounts multiplied by 12.5.

The amounts referred to in sub-paragraphs (a) and (b) must be calculated on the basis of the PD values set out in Article 165(1) and the corresponding LGD values set out in Article 165(2).

Institutions may recognise unfunded credit protection obtained on an equity position.

Risk-weighted exposure amounts for other non credit-obligation assets.

156. The risk-weighted exposure amounts for other non credit-obligation assets must be calculated in accordance with the following formula–

$$\text{Risk} - \text{weighted exposure amount} = 100\% \text{ exposure value},$$

except for–

(a) cash in hand and equivalent cash items as well as gold bullion held in own vault or on an allocated basis to the extent backed by bullion liabilities, in which case a 0% risk-weight is assigned;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(b) when the exposure is a residual value of leased assets in which case it must be calculated as follows–

$$\frac{1}{t} \times 100\ \% \times \text{exposure value}$$

where t is the greater of 1 and the nearest number of whole years of the lease remaining.

Risk-weighted exposure amounts for dilution risk of purchased receivables.

157.(1) Institutions must calculate the risk-weighted exposure amounts for dilution risk of purchased corporate and retail receivables in accordance with the formula set out in Article 153(1).

(2) Institutions must determine the input parameters PD and LGD in accordance with Articles 160 to 165.

(3) Institutions must determine the exposure value in accordance with Articles 166 to 168.

(4) For the purposes of this Article, the value of M is 1 year.

(5) The GFSC must exempt an institution from calculating and recognising risk-weighted exposure amounts for dilution risk of a type of exposures caused by purchased corporate or retail receivables where the institution has demonstrated to the satisfaction of the competent authority that dilution risk for that institution is immaterial for this type of exposures.

Expected loss amounts

Treatment by exposure type.

158.(1) The calculation of expected loss amounts must be based on the same input figures of PD, LGD and the exposure value for each exposure as are used for the calculation of risk-weighted exposure amounts in accordance with Article 151.

(2) The expected loss amounts for securitised exposures must be calculated in accordance with Chapter 5.

(3) The expected loss amount for exposures belonging to the “other non credit obligations assets” exposure class referred to in Article 147(2)(g) must be zero.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(4) The expected loss amounts for exposures in the form of shares or units of a CIU referred to in Article 152 must be calculated in accordance with the methods set out in this Article.

(5) The expected loss (EL) and expected loss amounts for exposures to corporates, institutions, central governments and central banks and retail exposures must be calculated in accordance with the following formulae–

Expected loss (EL) = PD * LGD

Expected loss amount = EL [multiplied by] exposure value.

For defaulted exposures (PD = 100%) where institutions use own estimates of LGDs, EL must be EL BE , the institution's best estimate of expected loss for the defaulted exposure in accordance with Article 181(1)(h).

For exposures subject to the treatment set out in Article 153(3), EL must be 0%.

(6) The EL values for specialised lending exposures where institutions use the methods set out in Article 153(5) for assigning risk weights are assigned in accordance with Table 2.

Table 2

Remaining Maturity	Category 1	Category 2	Category 3	Category 4	Category 5
Less than 2,5 years	0 %	0,4 %	2,8 %	8 %	50 %
Equal to or more than 2,5 years	0,4 %	0,8 %	2,8 %	8 %	50 %

(7) The expected loss amounts for equity exposures where the risk-weighted exposure amounts are calculated in accordance with the simple risk weight approach must be calculated in accordance with the following formula–

Expected loss amount = EL · exposure value

The EL values must be the following–

Expected loss (EL) = 0.8% for private equity exposures in sufficiently diversified portfolios

Expected loss (EL) = 0.8% for exchange traded equity exposures

Expected loss (EL) = 2.4% for all other equity exposures.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(8) The expected loss and expected loss amounts for equity exposures where the risk-weighted exposure amounts are calculated in accordance with the PD/LGD approach must be calculated in accordance with the following formula–

Expected loss (EL) = PD · LGD

Expected loss amount = EL · exposure value

(9) The expected loss amounts for equity exposures where the risk-weighted exposure amounts are calculated in accordance with the internal models approach must be zero.

(9A) [Not used]

(10) The expected loss amounts for dilution risk of purchased receivables must be calculated in accordance with the following formula–

Expected loss (EL) = PD · LGD

Expected loss amount = EL · exposure value

Treatment of expected loss amounts.

159. Institutions must subtract the expected loss amounts calculated in accordance with Article 158(5), (6) and (10) from the general and specific credit risk adjustments in accordance with Article 110, additional value adjustments in accordance with Articles 34 and 105 and other own funds reductions related to those exposures. Discounts on balance sheet exposures purchased when in default in accordance with Article 166(1) must be treated in the same manner as specific credit risk adjustments. Specific credit risk adjustments on exposures in default must not be used to cover expected loss amounts on other exposures. Expected loss amounts for securitised exposures and general and specific credit risk adjustments related to those exposures must not be included in that calculation.

PD, LGD and maturity

Probability of default (PD).

160.(1) The PD of an exposure to a corporate or an institution must be at least 0.03%.

(2) For purchased corporate receivables in respect of which an institution is not able to estimate PDs or an institution's PD estimates do not meet the requirements set out in Articles

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

169 to 191, the PDs for these exposures must be determined in accordance with the following methods–

(a) for senior claims on purchased corporate receivables PD must be the institutions estimate of EL divided by LGD for these receivables;

(b) for subordinated claims on purchased corporate receivables PD must be the institution's estimate of EL;

(c) an institution that has received GFSC approval to use own LGD estimates for corporate exposures pursuant to Article 143 and that can decompose its EL estimates for purchased corporate receivables into PDs and LGDs in a manner that the competent authority considers to be reliable, may use the PD estimate that results from this decomposition.

(3) The PD of obligors in default must be 100%.

(4) Institutions may take into account unfunded credit protection in the PD in accordance with the provisions of Chapter 4. For dilution risk, in addition to the protection providers referred to in Article 201(1)(g) the seller of the purchased receivables is eligible if the following conditions are met–

(a) the corporate entity has a credit assessment by an ECAI which has been determined by the GFSC to be associated with credit quality step 3 or above under the rules for the risk weighting of exposures to corporates under Chapter 2;

(b) the corporate entity, in the case of institutions calculating risk-weighted exposure amounts and expected loss amounts under the IRB Approach, does not have a credit assessment by a recognised ECAI and is internally rated as having a PD equivalent to that associated with the credit assessments of ECAIs determined by the GFSC to be associated with credit quality step 3 or above under the rules for the risk weighting of exposures to corporates under Chapter 2.

(5) Institutions using own LGD estimates may recognise unfunded credit protection by adjusting PDs subject to Article 161(3).

(6) For dilution risk of purchased corporate receivables, PD must be set equal to the EL estimate of the institution for dilution risk. An institution that has received GFSC approval pursuant to Article 143 to use own LGD estimates for corporate exposures that can decompose its EL estimates for dilution risk of purchased corporate receivables into PDs and LGDs in a manner that the competent authority considers to be reliable, may use the PD estimate that results from this decomposition. Institutions may recognise unfunded credit protection in the

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

PD in accordance with the provisions of Chapter 4. For dilution risk, in addition to the protection providers referred to in Article 201(1)(g), the seller of the purchased receivables is eligible if the conditions set out in paragraph (4) are met.

(7) By way of derogation from Article 201(1)(g), the corporate entities that meet the conditions set out in paragraph (4) are eligible.

An institution that has received GFSC approval pursuant to Article 143 to use own LGD estimates for dilution risk of purchased corporate receivables, may recognise unfunded credit protection by adjusting PDs subject to Article 161(3).

Loss Given Default (LGD).

161.(1) Institutions must use the following LGD values–

(a) senior exposures without eligible collateral– 45%;

(b) subordinated exposures without eligible collateral– 75%;

(c) institutions may recognise funded and unfunded credit protection in the LGD in accordance with Chapter 4;

(d) covered bonds eligible for the treatment set out in Article 129(4) or (5) may be assigned an LGD value of 11.25%;

(e) for senior purchased corporate receivables exposures where an institution is not able to estimate PDs or the institution's PD estimates do not meet the requirements set out in Articles 169 to 191 – 45%;

(f) for subordinated purchased corporate receivables exposures where an institution is not able to estimate PDs or the institution's PD estimates do not meet the requirements set out in Articles 169 to 191 – 100%;

(g) for dilution risk of purchased corporate receivables– 75%.

(2) For dilution and default risk if an institution has received GFSC approval to use own LGD estimates for corporate exposures pursuant to Article 143 and it can decompose its EL estimates for purchased corporate receivables into PDs and LGDs in a manner the competent authority considers to be reliable, the LGD estimate for purchased corporate receivables may be used.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(3) If an institution has received GFSC approval to use own LGD estimates for exposures to corporates, institutions, central governments and central banks pursuant to Article 143, unfunded credit protection may be recognised by adjusting PD or LGD subject to requirements as specified in Articles 169 to 191 and GFSC approval. An institution must not assign guaranteed exposures an adjusted PD or LGD such that the adjusted risk weight would be lower than that of a comparable, direct exposure to the guarantor.

(4) For the purposes of the undertakings referred to in Article 153(3), the LGD of a comparable direct exposure to the protection provider must either be the LGD associated with an unhedged facility to the guarantor or the unhedged facility of the obligor, depending upon whether in the event both the guarantor and obligor default during the life of the hedged transaction, available evidence and the structure of the guarantee indicate that the amount recovered would depend on the financial condition of the guarantor or obligor, respectively.

Maturity.

162.(1) Institutions that have not received approval to use own LGDs and own conversion factors for exposures to corporates, institutions or central governments and central banks must assign to exposures arising from repurchase transactions or securities or commodities lending or borrowing transactions a maturity value (M) of 0.5 years and to all other exposures M of 2.5 years.

Alternatively, as part of the approval referred to in Article 143, the GFSC may decide on whether the institution uses maturity (M) for each exposure as set out under paragraph (2).

(2) Institutions that have received GFSC approval to use own LGDs and own conversion factors for exposures to corporates, institutions or central governments and central banks pursuant to Article 143 must calculate M for each of these exposures as set out in sub-paragraphs (a) to (e) and subject to paragraphs (3) to (5). M must be no greater than five years except in the cases specified in Article 384(1) where M as specified there must be used–

(a) for an instrument subject to a cash flow schedule, M is calculated in accordance with the following formula–

$$M = \max\left\{1, \min\left\{\frac{\sum_t t \cdot CF_t}{\sum_t CF_t}, 5\right\}\right\}$$

(b) for derivatives subject to a master netting agreement, M must be the weighted average remaining maturity of the exposure, where M must be at least 1 year, and the notional amount of each exposure must be used for weighting the maturity;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(c) for exposures arising from fully or nearly-fully collateralised derivative instruments listed in Schedule 2 and fully or nearly-fully collateralised margin lending transactions which are subject to a master netting agreement, M must be the weighted average remaining maturity of the transactions where M must be at least 10 days;

(d) for repurchase transactions or securities or commodities lending or borrowing transactions which are subject to a master netting agreement, M must be the weighted average remaining maturity of the transactions where M must be at least five days. The notional amount of each transaction must be used for weighting the maturity;

(e) an institution that has received GFSC approval pursuant to Article 143 to use own PD estimates for purchased corporate receivables, for drawn amounts M must equal the purchased receivables exposure weighted average maturity, where M must be at least 90 days. This same value of M must also be used for undrawn amounts under a committed purchase facility if the facility contains effective covenants, early amortisation triggers, or other features that protect the purchasing institution against a significant deterioration in the quality of the future receivables it is required to purchase over the facility's term. Absent such effective protections, M for undrawn amounts must be calculated as the sum of the longest-dated potential receivable under the purchase agreement and the remaining maturity of the purchase facility, where M must be at least 90 days;

(f) for any instrument other than those referred to in this paragraph or when an institution is not in a position to calculate M as set out in sub-paragraph (a), M must be the maximum remaining time (in years) that the obligor is permitted to take to fully discharge its contractual obligations, where M must be at least one year;

(g) for institutions using the Internal Model Method set out in Articles 283 to 294 to calculate the exposure values, M must be calculated for exposures to which they apply this method and for which the maturity of the longest-dated contract contained in the netting set is greater than one year in accordance with the following formula–

$$M = \min\left\{\frac{\sum_k \mathrm{EffectiveEE}_{t_k} \cdot \Delta t_k \cdot \mathrm{df}_{t_k} \cdot s_{t_k} + \sum_k \mathrm{EE}_{t_k} \cdot \Delta t_k \cdot \mathrm{df}_{t_k} \cdot (1 - s_{t_k})}{\sum_k \mathrm{EffectiveEE}_{t_k} \cdot \Delta t_k \cdot \mathrm{df}_{t_k} \cdot s_{t_k}}, 5\right\}$$

where–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

S_{tk} = a dummy variable whose value at future period t_k is equal to 0 if t_k > 1 year and to 1 if $t_k \leq 1$;

EE_{tk} = the expected exposure at the future period t_k;

$EffectiveEE_{tk}$ = the effective expected exposure at the future period t_k;

df_{tk} = the risk-free discount factor for future time period tk;

$\Delta_{tk} = t_k - t_{k-1}$;

(h) an institution that uses an internal model to calculate a one-sided credit valuation adjustment (CVA) may use, subject to GFSC approval, the effective credit duration estimated by the internal model as M.

Subject to paragraph (2), for netting sets in which all contracts have an original maturity of less than one year the formula in sub-paragraph (a) applies;

(i) for institutions using the Internal Model Method set out in Articles 283 to 294, to calculate the exposure values and having an internal model approval for specific risk associated with traded debt positions in accordance with Chapter 5 of Title 4 of Part 3, M must be set to 1 in the formula laid out in Article 153(1), if an institution can demonstrate to the GFSC that its internal model for Specific risk associated with traded debt positions applied in Article 383 contains effects of rating migrations;

(j) for the purposes of Article 153(3), M must be the effective maturity of the credit protection but at least 1 year.

(3) Where the documentation requires daily re-margining and daily revaluation and includes provisions that allow for the prompt liquidation or set off of collateral in the event of default or failure to re-margin, M must be at least one-day for–

(a) fully or nearly-fully collateralised derivative instruments listed in Schedule 2;

(b) fully or nearly-fully collateralised margin lending transactions;

(c) repurchase transactions, securities or commodities lending or borrowing transactions.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

In addition, for qualifying short-term exposures which are not part of the institution's ongoing financing of the obligor, M must be at least one-day. Qualifying short term exposures must include the following–

(a) exposures to institutions or investment firms arising from settlement of foreign exchange obligations;

(b) self-liquidating short-term trade finance transactions connected to the exchange of goods or services with a residual maturity of up to one year;

(c) exposures arising from settlement of securities purchases and sales within the usual delivery period or two business days;

(d) exposures arising from cash settlements by wire transfer and settlements of electronic payment transactions and prepaid cost, including overdrafts arising from failed transactions that do not exceed a short, fixed agreed number of business days.

(4) For exposures to corporates situated in Gibraltar and having consolidated sales and consolidated assets of less than €500 million, institutions may choose to consistently set M as set out in paragraph (1) instead of applying paragraph (2). Institutions may replace €500 million total assets with €1,000 million total assets for corporates which primarily own and let non-speculative residential property.

(5) Maturity mismatches must be treated as specified in Chapter 4.

Probability of default (PD).

163.(1) The PD of an exposure must be at least 0.03%.

(2) The PD of obligors or, where an obligation approach is used, of exposures in default must be 100%.

(3) For dilution risk of purchased receivables PD must be set equal to EL estimates for dilution risk. If an institution can decompose its EL estimates for dilution risk of purchased receivables into PDs and LGDs in a manner the GFSC consider to be reliable, the PD estimate may be used.

(4) Unfunded credit protection may be taken into account by adjusting PDs subject to Article 164(2). For dilution risk, in addition to the protection providers referred to in Article 201(1)(g), the seller of the purchased receivables is eligible if the conditions set out in Article 160(4) are met.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Loss Given Default (LGD).

164.(1) Institutions must provide own estimates of LGDs subject to the requirements specified in Articles 169 to 191 and GFSC approval in accordance with Article 143. For dilution risk of purchased receivables, an LGD value of 75% must be used. If an institution can decompose its EL estimates for dilution risk of purchased receivables into PDs and LGDs in a reliable manner, the institution may use its own LGD estimate.

(2) Unfunded credit protection may be recognised as eligible by adjusting PD or LGD estimates subject to requirements as specified in Article 183(1), (2) and (3) and GFSC approval either in support of an individual exposure or a pool of exposures. An institution must not assign guaranteed exposures an adjusted PD or LGD such that the adjusted risk weight would be lower than that of a comparable, direct exposure to the guarantor.

(3) For the purposes of Article 154(2), the LGD of a comparable direct exposure to the protection provider referred to in Article 153(3) must either be the LGD associated with an unhedged facility to the guarantor or the unhedged facility of the obligor, depending upon whether, in the event both the guarantor and obligor default during the life of the hedged transaction, available evidence and the structure of the guarantee indicate that the amount recovered would depend on the financial condition of the guarantor or obligor, respectively.

(4) The exposure-weighted average LGD for all retail exposures secured by residential property and not benefiting from guarantees from central governments must not be lower than 10%.

The exposure-weighted average LGD for all retail exposures secured by commercial immovable property and not benefiting from guarantees from central governments must not be lower than 15%.

(5) The GFSC must inform the Minister of the its intention to make use of this Article and is appropriately involved in the assessment of financial stability concerns in Gibraltar in accordance with paragraph (6).

(6) Based on the data collected under Article 430A and on any other relevant indicators, and taking into account forward-looking immovable property market developments the GFSC must periodically, and at least annually, assess whether the minimum LGD values referred to in paragraph (4), are appropriate for exposures secured by mortgages on residential property or commercial immovable property located in Gibraltar.

Where, on the basis of the assessment referred to in the first sub-paragraph of this paragraph, the GFSC concludes that the minimum LGD values referred to in paragraph (4) are not

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

adequate, and if it considers that the inadequacy of LGD values could adversely affect current or future financial stability in Gibraltar, it may set higher minimum LGD values for those exposures located in one or more parts of the territory of the Member State of the relevant authority. Those higher minimum values may also be applied at the level of one or more property segments of such exposures.

(7) Where the GFSC sets higher minimum LGD values pursuant to paragraph (6), institutions must have a six-month transitional period to apply them.

(8) [Not used]

Equity exposures subject to the PD/LGD method.

165.(1) PDs must be determined in accordance with the methods for corporate exposures.

The following minimum PDs must apply–

(a) 0.09% for exchange traded equity exposures where the investment is part of a long-term customer relationship;

(b) 0.09% for non-exchange traded equity exposures where the returns on the investment are based on regular and periodic cash flows not derived from capital gains;

(c) 0.40% for exchange traded equity exposures including other short positions as set out in Article 155(2);

(d) 1.25% for all other equity exposures including other short positions as set out in Article 155(2).

(2) Private equity exposures in sufficiently diversified portfolios may be assigned an LGD of 65%. All other such exposures are assigned an LGD of 90%.

(3) M assigned to all exposures must be five years.

Exposure value

Exposures to corporates, institutions, central governments and central banks and retail exposures.

166.(1) Unless noted otherwise, the exposure value of on-balance sheet exposures must be the accounting value measured without taking into account any credit risk adjustments made.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

This rule also applies to assets purchased at a price different than the amount owed.

For purchased assets, the difference between the amount owed and the accounting value remaining after specific credit risk adjustments have been applied that has been recorded on the balance-sheet of the institutions when purchasing the asset is denoted discount if the amount owed is larger, and premium if it is smaller.

(2) Where institutions use master netting agreements in relation to repurchase transactions or securities or commodities lending or borrowing transactions, the exposure value must be calculated in accordance with Chapter 4 or 6.

(3) In order to calculate the exposure value for on-balance sheet netting of loans and deposits, institutions must apply the methods set out in Chapter 4.

(4) The exposure value for leases must be the discounted minimum lease payments. Minimum lease payments must comprise the payments over the lease term that the lessee is or can be required to make and any bargain option (i.e. option the exercise of which is reasonably certain). If a party other than the lessee may be required to make a payment related to the residual value of a leased asset and this payment obligation fulfils the set of conditions in Article 201 regarding the eligibility of protection providers as well as the requirements for recognising other types of guarantees provided in Article 213, the payment obligation may be taken into account as unfunded credit protection in accordance with Chapter 4.

(5) In the case of any contract listed in Schedule 2, the exposure value must be determined by the methods set out in Chapter 6 and must not take into account any credit risk adjustment made.

(6) The exposure value for the calculation of risk-weighted exposure amounts of purchased receivables must be the value determined in accordance with paragraph (1) minus the own funds requirements for dilution risk prior to credit risk mitigation.

(7) Where an exposure takes the form of securities or commodities sold, posted or lent under repurchase transactions or securities or commodities lending or borrowing transactions, long settlement transactions and margin lending transactions, the exposure value must be the value of the securities or commodities determined in accordance with Article 24. Where the Financial Collateral Comprehensive Method as set out under Article 223 is used, the exposure value must be increased by the volatility adjustment appropriate to such securities or commodities, as set out in that Article. The exposure value of repurchase transactions, securities or commodities lending or borrowing transactions, long settlement transactions and margin lending transactions may be determined either in accordance with Chapter 6 or Article 220(2).

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(8) The exposure value for the following items must be calculated as the committed but undrawn amount multiplied by a conversion factor. Institutions must use the following conversion factors in accordance with Article 151(8) for exposures to corporates, institutions, central governments and central banks–

(a) for credit lines that are unconditionally cancellable at any time by the institution without prior notice, or that effectively provide for automatic cancellation due to deterioration in a borrower's creditworthiness, a conversion factor of 0% must apply. To apply a conversion factor of 0%, institutions must actively monitor the financial condition of the obligor, and their internal control systems must enable them to immediately detect deterioration in the credit quality of the obligor. Undrawn credit lines may be considered as unconditionally cancellable if the terms permit the institution to cancel them to the full extent allowable under consumer protection and related legislation;

(b) for short-term letters of credit arising from the movement of goods, a conversion factor of 20% must apply for both the issuing and confirming institutions;

(c) for undrawn purchase commitments for revolving purchased receivables that are able to be unconditionally cancelled or that effectively provide for automatic cancellation at any time by the institution without prior notice, a conversion factor of 0% applies. To apply a conversion factor of 0%, institutions must actively monitor the financial condition of the obligor, and their internal control systems must enable them to immediately detect a deterioration in the credit quality of the obligor;

(d) for other credit lines, note issuance facilities (NIFs), and revolving underwriting facilities (RUFs), a conversion factor of 75% applies.

Institutions which meet the requirements for the use of own estimates of conversion factors as specified in Articles 169 to 191 may use their own estimates of conversion factors across different product types as mentioned in sub-paragraphs (a) to (d), subject to GFSC approval.

(9) Where a commitment refers to the extension of another commitment, the lower of the two conversion factors associated with the individual commitment must be used.

(10) For all off-balance sheet items other than those mentioned in paragraphs (1) to (8), the exposure value must be the following percentage of its value–

(a) 100% if it is a full risk item;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(b) 50% if it is a medium-risk item;

(c) 20% if it is a medium/low-risk item;

(d) 0% if it is a low-risk item.

For the purposes of this paragraph the off-balance sheet items must be assigned to risk categories as indicated in Schedule 1.

Equity exposures.

167.(1) The exposure value of equity exposures must be the accounting value remaining after specific credit risk adjustment have been applied.

(2) The exposure value of off-balance sheet equity exposures must be its nominal value after reducing its nominal value by specific credit risk adjustments for this exposure.

Other non credit-obligation assets.

168. The exposure value of other non credit-obligation assets must be the accounting value remaining after specific credit risk adjustment have been applied.

Requirements for the IRB approach

General principles.

169.(1) Where an institution uses multiple rating systems, the rationale for assigning an obligor or a transaction to a rating system must be documented and applied in a manner that appropriately reflects the level of risk.

(2) Assignment criteria and processes must be periodically reviewed to determine whether they remain appropriate for the current portfolio and external conditions.

(3) Where an institution uses direct estimates of risk parameters for individual obligors or exposures these may be seen as estimates assigned to grades on a continuous rating scale.

Structure of rating systems.

170.(1) The structure of rating systems for exposures to corporates, institutions and central governments and central banks must comply with the following requirements–

(a) a rating system must take into account obligor and transaction risk characteristics;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(b) a rating system must have an obligor rating scale which reflects exclusively quantification of the risk of obligor default. The obligor rating scale must have a minimum of 7 grades for non-defaulted obligors and one for defaulted obligors;

(c) an institution must document the relationship between obligor grades in terms of the level of default risk each grade implies and the criteria used to distinguish that level of default risk;

(d) institutions with portfolios concentrated in a particular market segment and range of default risk must have enough obligor grades within that range to avoid undue concentrations of obligors in a particular grade. Significant concentrations within a single grade must be supported by convincing empirical evidence that the obligor grade covers a reasonably narrow PD band and that the default risk posed by all obligors in the grade falls within that band;

(e) to be permitted by the competent authority to use own estimates of LGDs for own funds requirement calculation, a rating system must incorporate a distinct facility rating scale which exclusively reflects LGD related transaction characteristics. The facility grade definition must include both a description of how exposures are assigned to the grade and of the criteria used to distinguish the level of risk across grades;

(f) significant concentrations within a single facility grade must be supported by convincing empirical evidence that the facility grade covers a reasonably narrow LGD band, respectively, and that the risk posed by all exposures in the grade falls within that band.

(2) Institutions using the methods set out in Article 153(5) for assigning risk weights for specialised lending exposures are exempt from the requirement to have an obligor rating scale which reflects exclusively quantification of the risk of obligor default for these exposures. These institutions must have for these exposures at least four grades for non-defaulted obligors and at least one grade for defaulted obligors.

(3) The structure of rating systems for retail exposures must comply with the following requirements–

(a) rating systems must reflect both obligor and transaction risk, and capture all relevant obligor and transaction characteristics;

(b) the level of risk differentiation must ensure that the number of exposures in a given grade or pool is sufficient to allow for meaningful quantification and validation of

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

the loss characteristics at the grade or pool level. The distribution of exposures and obligors across grades or pools must be such as to avoid excessive concentrations;

(c) the process of assigning exposures to grades or pools must provide for a meaningful differentiation of risk, for a grouping of sufficiently homogenous exposures, and must allow for accurate and consistent estimation of loss characteristics at grade or pool level. For purchased receivables the grouping must reflect the seller's underwriting practices and the heterogeneity of its customers.

(4) Institutions must consider the following risk drivers when assigning exposures to grades or pools–

(a) obligor risk characteristics;

(b) transaction risk characteristics, including product or collateral types or both. Institutions must explicitly address cases where several exposures benefit from the same collateral;

(c) delinquency, except where an institution demonstrates to the satisfaction of its competent authority that delinquency is not a material driver of risk for the exposure.

Assignment to grades or pools.

171.(1) An institution must have specific definitions, processes and criteria for assigning exposures to grades or pools within a rating system that comply with the following requirements–

(a) the grade or pool definitions and criteria must be sufficiently detailed to allow those charged with assigning ratings to consistently assign obligors or facilities posing similar risk to the same grade or pool. This consistency must exist across lines of business, departments and geographic locations;

(b) the documentation of the rating process must allow third parties to understand the assignments of exposures to grades or pools, to replicate grade and pool assignments and to evaluate the appropriateness of the assignments to a grade or a pool;

(c) the criteria must also be consistent with the institution's internal lending standards and its policies for handling troubled obligors and facilities.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(2) An institution must take all relevant information into account in assigning obligors and facilities to grades or pools. Information must be current and enable the institution to forecast the future performance of the exposure. The less information an institution has, the more conservative must be its assignments of exposures to obligor and facility grades or pools. If an institution uses an external rating as a primary factor determining an internal rating assignment, the institution must ensure that it considers other relevant information.

Assignment of exposures.

172.(1) For exposures to corporates, institutions and central governments and central banks, and for equity exposures where an institution uses the PD/LGD approach set out in Article 155(3), assignment of exposures must be carried out in accordance with the following criteria–

(a) each obligor must be assigned to an obligor grade as part of the credit approval process;

(b) for those exposures for which an institution has received GFSC approval to use own estimates of LGDs and conversion factors pursuant to Article 143, each exposure must also be assigned to a facility grade as part of the credit approval process;

(c) institutions using the methods set out in Article 153(5) for assigning risk weights for specialised lending exposures must assign each of these exposures to a grade in accordance with Article 170(2);

(d) each separate legal entity to which the institution is exposed must be separately rated. An institution must have appropriate policies regarding the treatment of individual obligor clients and groups of connected clients;

(e) separate exposures to the same obligor must be assigned to the same obligor grade, irrespective of any differences in the nature of each specific transaction. However, where separate exposures are allowed to result in multiple grades for the same obligor, the following must apply–

(i) country transfer risk, this being dependent on whether the exposures are denominated in local or foreign currency;

(ii) the treatment of associated guarantees to an exposure may be reflected in an adjusted assignment to an obligor grade;

(iii) consumer protection, bank secrecy or other legislation prohibit the exchange of client data.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(2) For retail exposures, each exposure must be assigned to a grade or a pool as part of the credit approval process.

(3) For grade and pool assignments institutions must document the situations in which human judgement may override the inputs or outputs of the assignment process and the personnel responsible for approving these overrides. Institutions must document these overrides and note down the personnel responsible. Institutions must analyse the performance of the exposures whose assignments have been overridden. This analysis must include an assessment of the performance of exposures whose rating has been overridden by a particular person, accounting for all the responsible personnel.

Integrity of assignment process.

173.(1) For exposures to corporates, institutions and central governments and central banks, and for equity exposures where an institution uses the PD/LGD approach set out in Article 155(3), the assignment process must meet the following requirements of integrity–

(a) Assignments and periodic reviews of assignments must be completed or approved by an independent party that does not directly benefit from decisions to extend the credit;

(b) Institutions must review assignments at least annually and adjust the assignment where the result of the review does not justify carrying forward the current assignment. High risk obligors and problem exposures must be subject to more frequent review. Institutions must undertake a new assignment if material information on the obligor or exposure becomes available;

(c) An institution must have an effective process to obtain and update relevant information on obligor characteristics that affect PDs, and on transaction characteristics that affect LGDs or conversion factors.

(2) For retail exposures, an institution must at least annually review obligor and facility assignments and adjust the assignment where the result of the review does not justify carrying forward the current assignment, or review the loss characteristics and delinquency status of each identified risk pool, whichever applicable. An institution must also at least annually review in a representative sample the status of individual exposures within each pool as a means of ensuring that exposures continue to be assigned to the correct pool, and adjust the assignment where the result of the review does not justify carrying forward the current assignment.

(3) [Not used]

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Use of models.

174. If an institution uses statistical models and other mechanical methods to assign exposures to obligors or facilities grades or pools, the following requirements must be met–

(a) the model must have good predictive power and capital requirements must not be distorted as a result of its use. The input variables must form a reasonable and effective basis for the resulting predictions. The model must not have material biases;

(b) the institution must have in place a process for vetting data inputs into the model, which includes an assessment of the accuracy, completeness and appropriateness of the data;

(c) the data used to build the model must be representative of the population of the institution's actual obligors or exposures;

(d) the institution must have a regular cycle of model validation that includes monitoring of model performance and stability; review of model specification; and testing of model outputs against outcomes;

(e) the institution must complement the statistical model by human judgement and human oversight to review model-based assignments and to ensure that the models are used appropriately. Review procedures must aim at finding and limiting errors associated with model weaknesses. Human judgements must take into account all relevant information not considered by the model. The institution must document how human judgement and model results are to be combined.

Documentation of rating systems.

175.(1) The institutions must document the design and operational details of its rating systems. The documentation must provide evidence of compliance with the requirements in Articles 169 to 191, and address topics including portfolio differentiation, rating criteria, responsibilities of parties that rate obligors and exposures, frequency of assignment reviews, and management oversight of the rating process.

(2) The institution must document the rationale for and analysis supporting its choice of rating criteria. An institution must document all major changes in the risk rating process, and such documentation must support identification of changes made to the risk rating process subsequent to the last review by the GFSC. The organisation of rating assignment including the rating assignment process and the internal control structure must also be documented.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(3) The institutions must document the specific definitions of default and loss used internally and ensure consistency with the definitions set out in these Standards.

(4) Where the institution employs statistical models in the rating process, the institution must document their methodologies. This material must–

(a) provide a detailed outline of the theory, assumptions and mathematical and empirical basis of the assignment of estimates to grades, individual obligors, exposures, or pools, and the data source(s) used to estimate the model;

(b) establish a rigorous statistical process including out-of-time and out-of-sample performance tests for validating the model;

(c) indicate any circumstances under which the model does not work effectively.

(5) An institution must demonstrate to the satisfaction of the GFSC that the requirements of this Article are met, where an institution has obtained a rating system, or model used within a rating system, from a third-party vendor and that vendor refuses or restricts the access of the institution to information pertaining to the methodology of that rating system or model, or underlying data used to develop that methodology or model, on the basis that such information is proprietary.

Data maintenance.

176.(1) Institutions must collect and store data on aspects of their internal ratings as required under Part 8.

(2) For exposures to corporates, institutions and central governments and central banks, and for equity exposures where an institution uses the PD/LGD approach set out in Article 155(3), institutions must collect and store–

(a) complete rating histories on obligors and recognised guarantors;

(b) the dates the ratings were assigned;

(c) the key data and methodology used to derive the rating;

(d) the person responsible for the rating assignment;

(e) the identity of obligors and exposures that defaulted;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(f) the date and circumstances of such defaults;

(g) data on the PDs and realised default rates associated with rating grades and ratings migration.

(3) Institutions not using own estimates of LGDs and conversion factors must collect and store data on comparisons of realised LGDs to the values as set out in Article 161(1) and realised conversion factors to the values as set out in Article 166(8).

(4) Institutions using own estimates of LGDs and conversion factors must collect and store–

(a) complete histories of data on the facility ratings and LGD and conversion factor estimates associated with each rating scale;

(b) the dates on which the ratings were assigned and the estimates were made;

(c) the key data and methodology used to derive the facility ratings and LGD and conversion factor estimates;

(d) the person who assigned the facility rating and the person who provided LGD and conversion factor estimates;

(e) data on the estimated and realised LGDs and conversion factors associated with each defaulted exposure;

(f) data on the LGD of the exposure before and after evaluation of the effects of a guarantee/or credit derivative, for those institutions that reflect the credit risk mitigating effects of guarantees or credit derivatives through LGD;

(g) data on the components of loss for each defaulted exposure.

(5) For retail exposures, institutions must collect and store–

(a) data used in the process of allocating exposures to grades or pools;

(b) data on the estimated PDs, LGDs and conversion factors associated with grades or pools of exposures;

(c) the identity of obligors and exposures that defaulted;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(d) for defaulted exposures, data on the grades or pools to which the exposure was assigned over the year prior to default and the realised outcomes on LGD and conversion factor;

(e) data on loss rates for qualifying revolving retail exposures.

Stress tests used in assessment of capital adequacy.

177.(1) An institution must have in place sound stress testing processes for use in the assessment of its capital adequacy. Stress testing must involve identifying possible events or future changes in economic conditions that could have unfavourable effects on an institution's credit exposures and assessment of the institution's ability to withstand such changes.

(2) An institution must regularly perform a credit risk stress test to assess the effect of certain specific conditions on its total capital requirements for credit risk. The test must be one chosen by the institution, subject to supervisory review. The test to be employed must be meaningful and consider the effects of severe, but plausible, recession scenarios. An institution must assess migration in its ratings under the stress test scenarios. Stressed portfolios must contain the vast majority of an institution's total exposure.

(3) Institutions using the treatment set out in Article 153(3) must consider as part of their stress testing framework the impact of a deterioration in the credit quality of protection providers, in particular the impact of protection providers falling outside the eligibility criteria.

Default of an obligor.

178.(1) A default must be considered to have occurred with regard to a particular obligor when either or both of the following have taken place–

(a) the institution considers that the obligor is unlikely to pay its credit obligations to the institution, the parent undertaking or any of its subsidiaries in full, without recourse by the institution to actions such as realising security;

(b) the obligor is more than 90 days past due on any material credit obligation to the institution, the parent undertaking or any of its subsidiaries. The GFSC may replace the 90 days with 180 days for exposures secured by residential property or SME commercial immovable property in the retail exposure class, as well as exposures to public sector entities. The 180 days must not apply for the purposes Article 127.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

In the case of retail exposures, institutions may apply the definition of default laid down in sub-paragraphs (a) and (b) at the level of an individual credit facility rather than in relation to the total obligations of a borrower.

(2) The following must apply for the purposes of paragraph (1)(b)–

(a) for overdrafts, days past due commence once an obligor has breached an advised limit, has been advised a limit smaller than current outstandings, or has drawn credit without authorisation and the underlying amount is material;

(b) for the purposes of sub-paragraph (a), an advised limit comprises any credit limit determined by the institution and about which the obligor has been informed by the institution;

(c) days past due for credit cards commence on the minimum payment due date;

(d) materiality of a credit obligation past due must be assessed against a threshold, defined by the competent authorities. This threshold must reflect a level of risk that the competent authority considers to be reasonable;

(e) institutions must have documented policies in respect of the counting of days past due, in particular in respect of the re-ageing of the facilities and the granting of extensions, amendments or deferrals, renewals, and netting of existing accounts. These policies must be applied consistently over time, and must be in line with the internal risk management and decision processes of the institution.

(3) For the purpose of paragraph (1)(a), elements to be taken as indications of unlikeliness to pay must include the following–

(a) the institution puts the credit obligation on non-accrued status;

(b) the institution recognises a specific credit adjustment resulting from a significant perceived decline in credit quality subsequent to the institution taking on the exposure;

(c) the institution sells the credit obligation at a material credit-related economic loss;

(d) the institution consents to a distressed restructuring of the credit obligation where this is likely to result in a diminished financial obligation caused by the material forgiveness, or postponement, of principal, interest or, where relevant fees. This includes, in the case of equity exposures assessed under a PD/LGD Approach, distressed restructuring of the equity itself;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(e) the institution has filed for the obligor's bankruptcy or a similar order in respect of an obligor's credit obligation to the institution, the parent undertaking or any of its subsidiaries;

(f) the obligor has sought or has been placed in bankruptcy or similar protection where this would avoid or delay repayment of a credit obligation to the institution, the parent undertaking or any of its subsidiaries.

(4) Institutions that use external data that is not itself consistent with the definition of default laid down in paragraph (1), must make appropriate adjustments to achieve broad equivalence with the definition of default.

(5) If the institution considers that a previously defaulted exposure is such that no trigger of default continues to apply, the institution must rate the obligor or facility as they would for a non-defaulted exposure. Where the definition of default is subsequently triggered, another default would be deemed to have occurred.

(6) [Not used]

Overall requirements for estimation.

179.(1) In quantifying the risk parameters to be associated with rating grades or pools, institutions must apply the following requirements–

(a) an institution's own estimates of the risk parameters PD, LGD, conversion factor and EL must incorporate all relevant data, information and methods. The estimates must be derived using both historical experience and empirical evidence, and not based purely on judgemental considerations. The estimates must be plausible and intuitive and must be based on the material drivers of the respective risk parameters. The less data an institution has, the more conservative it must be in its estimation;

(b) an institution must be able to provide a breakdown of its loss experience in terms of default frequency, LGD, conversion factor, or loss where EL estimates are used, by the factors it sees as the drivers of the respective risk parameters. The institution's estimates must be representative of long run experience;

(c) any changes in lending practice or the process for pursuing recoveries over the observation periods referred to in Article 180(1)(h) and (2)(e), Article 181(1)(j) and (2), and Article 182(2) and (3) must be taken into account. An institution's estimates must reflect the implications of technical advances and new data and

other information, as it becomes available. Institutions must review their estimates when new information comes to light but at least on an annual basis;

(d) the population of exposures represented in the data used for estimation, the lending standards used when the data was generated and other relevant characteristics must be comparable with those of the institution's exposures and standards. The economic or market conditions that underlie the data must be relevant to current and foreseeable conditions. The number of exposures in the sample and the data period used for quantification must be sufficient to provide the institution with confidence in the accuracy and robustness of its estimates;

(e) for purchased receivables the estimates must reflect all relevant information available to the purchasing institution regarding the quality of the underlying receivables, including data for similar pools provided by the seller, by the purchasing institution, or by external sources. The purchasing institution must evaluate any data relied upon which is provided by the seller;

(f) an institution must add to its estimates a margin of conservatism that is related to the expected range of estimation errors. Where methods and data are considered to be less satisfactory, the expected range of errors is larger, the margin of conservatism must be larger.

Where institutions use different estimates for the calculation of risk weights and for internal purposes, it must be documented and be reasonable. If institutions can demonstrate to their the GFSC that for data that have been collected prior to 1 January 2007 appropriate adjustments have been made to achieve broad equivalence with the definition of default laid down in Article 178 or with loss, the GFSC may permit the institutions some flexibility in the application of the required standards for data.

(2) Where an institution uses data that is pooled across institutions it must meet the following requirements–

(a) the rating systems and criteria of other institutions in the pool are similar to its own;

(b) the pool is representative of the portfolio for which the pooled data is used;

(c) the pooled data is used consistently over time by the institution for its estimates;

(d) the institution must remain responsible for the integrity of its rating systems;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(e) the institution must maintain sufficient in-house understanding of its rating systems, including the ability to effectively monitor and audit the rating process.

Requirements specific to PD estimation.

180.(1) In quantifying the risk parameters to be associated with rating grades or pools, institutions must apply the following requirements specific to PD estimation to exposures to corporates, institutions and central governments and central banks and for equity exposures where an institution uses the PD/LGD approach set out in Article 155(3) –

(a) institutions must estimate PDs by obligor grade from long run averages of one-year default rates. PD estimates for obligors that are highly leveraged or for obligors whose assets are predominantly traded assets must reflect the performance of the underlying assets based on periods of stressed volatilities;

(b) for purchased corporate receivables institutions may estimate the EL by obligor grade from long run averages of one-year realised default rates;

(c) if an institution derives long run average estimates of PDs and LGDs for purchased corporate receivables from an estimate of EL, and an appropriate estimate of PD or LGD, the process for estimating total losses must meet the overall standards for estimation of PD and LGD set out in this part, and the outcome must be consistent with the concept of LGD as set out in Article 181(1)(a);

(d) institutions must use PD estimation techniques only with supporting analysis. Institutions must recognise the importance of judgmental considerations in combining results of techniques and in making adjustments for limitations of techniques and information;

(e) to the extent that an institution uses data on internal default experience for the estimation of PDs, the estimates must be reflective of underwriting standards and of any differences in the rating system that generated the data and the current rating system. Where underwriting standards or rating systems have changed, the institution must add a greater margin of conservatism in its estimate of PD;

(f) to the extent that an institution associates or maps its internal grades to the scale used by an ECAI or similar organisations and then attributes the default rate observed for the external organisation's grades to the institution's grades, mappings must be based on a comparison of internal rating criteria to the criteria used by the external organisation and on a comparison of the internal and external ratings of any common obligors. Biases or inconsistencies in the mapping approach or underlying data must be avoided. The criteria of the external organisation

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

underlying the data used for quantification must be oriented to default risk only and not reflect transaction characteristics. The analysis undertaken by the institution must include a comparison of the default definitions used, subject to the requirements in Article 178. The institution must document the basis for the mapping;

(g) to the extent that an institution uses statistical default prediction models it is allowed to estimate PDs as the simple average of default-probability estimates for individual obligors in a given grade. The institution's use of default probability models for this purpose must meet the standards specified in Article 174;

(h) irrespective of whether an institution is using external, internal, or pooled data sources, or a combination of the three, for its PD estimation, the length of the underlying historical observation period used must be at least five years for at least one source. If the available observation period spans a longer period for any source, and this data is relevant, this longer period must be used. This sub-paragraph also applies to the PD/LGD Approach to equity. Subject to GFSC approval, institutions which have not GFSC approval pursuant to Article 143 to use own estimates of LGDs or conversion factors may use, when they implement the IRB Approach, relevant data covering a period of two years. The period to be covered must increase by one year each year until relevant data cover a period of five years.

(2) For retail exposures, the following requirements must apply–

(a) institutions must estimate PDs by obligor grade or pool from long run averages of one-year default rates;

(b) PD estimates may also be derived from an estimate of total losses and appropriate estimates of LGDs;

(c) institutions must regard internal data for assigning exposures to grades or pools as the primary source of information for estimating loss characteristics. Institutions may use external data (including pooled data) or statistical models for quantification if the following strong links both exist–

(i) between the institution's process of assigning exposures to grades or pools and the process used by the external data source; and

(ii) between the institution's internal risk profile and the composition of the external data;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(d) if an institution derives long run average estimates of PD and LGD for retail exposures from an estimate of total losses and an appropriate estimate of PD or LGD, the process for estimating total losses must meet the overall standards for estimation of PD and LGD set out in this part, and the outcome must be consistent with the concept of LGD as set out in Article 181(1)(a);

(e) irrespective of whether an institution is using external, internal or pooled data sources or a combination of the three, for their estimation of loss characteristics, the length of the underlying historical observation period used must be at least five years for at least one source. If the available observation spans a longer period for any source, and these data are relevant, this longer period must be used. An institution need not give equal importance to historic data if more recent data is a better predictor of loss rates. Subject to GFSC approval, institutions may use, when they implement the IRB Approach, relevant data covering a period of two years. The period to be covered must increase by one year each year until relevant data cover a period of five years;

(f) institutions must identify and analyse expected changes of risk parameters over the life of credit exposures (seasoning effects).

For purchased retail receivables, institutions may use external and internal reference data. Institutions must use all relevant data sources as points of comparison.

(3) [Not used]

Requirements specific to own-LGD estimates.

181.(1) In quantifying the risk parameters to be associated with rating grades or pools, institutions must apply the following requirements specific to own-LGD estimates–

(a) institutions must estimate LGDs by facility grade or pool on the basis of the average realised LGDs by facility grade or pool using all observed defaults within the data sources (default weighted average);

(b) institutions must use LGD estimates that are appropriate for an economic downturn if those are more conservative than the long-run average. To the extent a rating system is expected to deliver realised LGDs at a constant level by grade or pool over time, institutions must make adjustments to their estimates of risk parameters by grade or pool to limit the capital impact of an economic downturn;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(c) an institution must consider the extent of any dependence between the risk of the obligor and that of the collateral or collateral provider. Cases where there is a significant degree of dependence must be addressed in a conservative manner;

(d) currency mismatches between the underlying obligation and the collateral must be treated conservatively in the institution's assessment of LGD;

(e) to the extent that LGD estimates take into account the existence of collateral, these estimates must not solely be based on the collateral's estimated market value. LGD estimates must take into account the effect of the potential inability of institutions to expeditiously gain control of their collateral and liquidate it;

(f) to the extent that LGD estimates take into account the existence of collateral, institutions must establish internal requirements for collateral management, legal certainty and risk management that are generally consistent with those set out in Articles 218 to 236;

(g) to the extent that an institution recognises collateral for determining the exposure value for counterparty credit risk in accordance with Articles 282 to 294, any amount expected to be recovered from the collateral must not be taken into account in the LGD estimates;

(h) for the specific case of exposures already in default, the institution must use the sum of its best estimate of expected loss for each exposure given current economic circumstances and exposure status and its estimate of the increase of loss rate caused by possible additional unexpected losses during the recovery period, i.e. between date of default and final liquidation of the exposure;

(i) to the extent that unpaid late fees have been capitalised in the institution's income statement, they must be added to the institution's measure of exposure and loss;

(j) for exposures to corporates, institutions and central governments and central banks, estimates of LGD must be based on data over a minimum of five years, increasing by one year each year after implementation until a minimum of seven years is reached, for at least one data source. If the available observation period spans a longer period for any source, and the data is relevant, this longer period must be used.

(2) For retail exposures, institutions may do the following–

(a) derive LGD estimates from realised losses and appropriate estimates of PDs;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(b) reflect future drawings either in their conversion factors or in their LGD estimates;

(c) For purchased retail receivables use external and internal reference data to estimate LGDs.

For retail exposures, estimates of LGD must be based on data over a minimum of five years. An institution need not give equal importance to historic data if more recent data is a better predictor of loss rates. Subject to GFSC approval, institutions may use, when they implement the IRB Approach, relevant data covering a period of two years. The period to be covered must increase by one year each year until relevant data cover a period of five years.

(3) [Not used]

Requirements specific to own-conversion factor estimates.

182.(1) In quantifying the risk parameters to be associated with rating grades or pools, institutions must apply the following requirements specific to own-conversion factor estimates–

(a) institutions must estimate conversion factors by facility grade or pool on the basis of the average realised conversion factors by facility grade or pool using the default weighted average resulting from all observed defaults within the data sources;

(b) institutions must use conversion factor estimates that are appropriate for an economic downturn if those are more conservative than the long-run average. To the extent a rating system is expected to deliver realised conversion factors at a constant level by grade or pool over time, institutions must make adjustments to their estimates of risk parameters by grade or pool to limit the capital impact of an economic downturn;

(c) institutions' estimates of conversion factors must reflect the possibility of additional drawings by the obligor up to and after the time a default event is triggered. The conversion factor estimate must incorporate a larger margin of conservatism where a stronger positive correlation can reasonably be expected between the default frequency and the magnitude of conversion factor;

(d) in arriving at estimates of conversion factors institutions must consider their specific policies and strategies adopted in respect of account monitoring and payment processing. Institutions must also consider their ability and willingness to prevent further drawings in circumstances short of payment default, such as covenant violations or other technical default events;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(e) institutions must have adequate systems and procedures in place to monitor facility amounts, current outstandings against committed lines and changes in outstandings per obligor and per grade. The institution must be able to monitor outstanding balances on a daily basis;

(f) if institutions use different estimates of conversion factors for the calculation of risk-weighted exposure amounts and internal purposes it must be documented and be reasonable.

(2) For exposures to corporates, institutions and central governments and central banks, estimates of conversion factors must be based on data over a minimum of five years, increasing by one year each year after implementation until a minimum of seven years is reached, for at least one data source. If the available observation period spans a longer period for any source, and the data is relevant, this longer period must be used.

(3) For retail exposures, institutions may reflect future drawings either in their conversion factors or in their LGD estimates.

For retail exposures, estimates of conversion factors must be based on data over a minimum of five years. By way of derogation from paragraph (1)(a), an institution need not give equal importance to historic data if more recent data is a better predictor of drawdowns. Subject to GFSC approval, institutions may use, when they implement the IRB Approach, relevant data covering a period of two years. The period to be covered must increase by one year each year until relevant data cover a period of five years.

(4) [Not used]

Requirements for assessing the effect of guarantees and credit derivatives for exposures to corporates, institutions and central governments and central banks where own estimates of LGD are used and for retail exposures.

183.(1) The following requirements must apply in relation to eligible guarantors and guarantees–

(a) institutions must have clearly specified criteria for the types of guarantors they recognise for the calculation of risk-weighted exposure amounts;

(b) for recognised guarantors the same rules as for obligors as set out in Articles 171, 172 and 173 must apply;

(c) the guarantee must be evidenced in writing, non-cancellable on the part of the guarantor, in force until the obligation is satisfied in full (to the extent of the

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

amount and tenor of the guarantee) and legally enforceable against the guarantor in a jurisdiction where the guarantor has assets to attach and enforce a judgement. Conditional guarantees prescribing conditions under which the guarantor may not be obliged to perform may be recognised subject to GFSC approval. The assignment criteria must adequately address any potential reduction in the risk mitigation effect.

(2) An institution must have clearly specified criteria for adjusting grades, pools or LGD estimates, and, in the case of retail and eligible purchased receivables, the process of allocating exposures to grades or pools, to reflect the impact of guarantees for the calculation of risk-weighted exposure amounts. These criteria must comply with the requirements set out in Articles 171, 172 and 173.

The criteria must be plausible and intuitive. They must address the guarantor's ability and willingness to perform under the guarantee, the likely timing of any payments from the guarantor, the degree to which the guarantor's ability to perform under the guarantee is correlated with the obligor's ability to repay, and the extent to which residual risk to the obligor remains.

(3) The requirements for guarantees in this Article must apply also for single-name credit derivatives. In relation to a mismatch between the underlying obligation and the reference obligation of the credit derivative or the obligation used for determining whether a credit event has occurred, the requirements set out under Article 216(2) must apply. For retail exposures and eligible purchased receivables, this paragraph applies to the process of allocating exposures to grades or pools.

The criteria must address the payout structure of the credit derivative and conservatively assess the impact this has on the level and timing of recoveries. The institution must consider the extent to which other forms of residual risk remain.

(4) The requirements set out in paragraphs (1) to (3) must not apply for guarantees provided by institutions, central governments and central banks, and corporate entities which meet the requirements laid down in Article 201(1)(g) if the institution has received approval to apply the Standardised Approach for exposures to such entities pursuant to Articles 148 and 150. In this case the requirements of Chapter 4 must apply.

(5) For retail guarantees, the requirements set out in paragraphs (1), (2) and (3) must also apply to the assignment of exposures to grades or pools, and the estimation of PD.

(6) [Not used]

Requirements for purchased receivables.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

184.(1) In quantifying the risk parameters to be associated with rating grades or pools for purchased receivables, institutions must ensure the conditions laid down in paragraphs (2) to (6) are met.

(2) The structure of the facility must ensure that under all foreseeable circumstances the institution has effective ownership and control of all cash remittances from the receivables. When the obligor makes payments directly to a seller or servicer, the institution must verify regularly that payments are forwarded completely and within the contractually agreed terms. Institutions must have procedures to ensure that ownership over the receivables and cash receipts is protected against bankruptcy stays or legal challenges that could materially delay the lender's ability to liquidate or assign the receivables or retain control over cash receipts.

(3) The institution must monitor both the quality of the purchased receivables and the financial condition of the seller and servicer. The following must apply–

(a) the institution must assess the correlation among the quality of the purchased receivables and the financial condition of both the seller and servicer, and have in place internal policies and procedures that provide adequate safeguards to protect against any contingencies, including the assignment of an internal risk rating for each seller and servicer;

(b) the institution must have clear and effective policies and procedures for determining seller and servicer eligibility. The institution or its agent must conduct periodic reviews of sellers and servicers in order to verify the accuracy of reports from the seller or servicer, detect fraud or operational weaknesses, and verify the quality of the seller's credit policies and servicer's collection policies and procedures. The findings of these reviews must be documented;

(c) the institution must assess the characteristics of the purchased receivables pools, including over-advances; history of the seller's arrears, bad debts, and bad debt allowances; payment terms, and potential contra accounts;

(d) the institution must have effective policies and procedures for monitoring on an aggregate basis single-obligor concentrations both within and across purchased receivables pools;

(e) the institution must ensure that it receives from the servicer timely and sufficiently detailed reports of receivables ageings and dilutions to ensure compliance with the institution's eligibility criteria and advancing policies governing purchased receivables, and provide an effective means with which to monitor and confirm the seller's terms of sale and dilution.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(4) The institution must have systems and procedures for detecting deteriorations in the seller's financial condition and purchased receivables quality at an early stage, and for addressing emerging problems pro-actively. In particular, the institution must have clear and effective policies, procedures, and information systems to monitor covenant violations, and clear and effective policies and procedures for initiating legal actions and dealing with problem purchased receivables.

(5) The institution must have clear and effective policies and procedures governing the control of purchased receivables, credit, and cash. In particular, written internal policies must specify all material elements of the receivables purchase programme, including the advancing rates, eligible collateral, necessary documentation, concentration limits, and the way cash receipts are to be handled. These elements must take appropriate account of all relevant and material factors, including the seller and servicer's financial condition, risk concentrations, and trends in the quality of the purchased receivables and the seller's customer base, and internal systems must ensure that funds are advanced only against specified supporting collateral and documentation.

(6) The institution must have an effective internal process for assessing compliance with all internal policies and procedures. The process must include regular audits of all critical phases of the institution's receivables purchase programme, verification of the separation of duties between firstly the assessment of the seller and servicer and the assessment of the obligor and secondly between the assessment of the seller and servicer and the field audit of the seller and servicer, and evaluations of back office operations, with particular focus on qualifications, experience, staffing levels, and supporting automation systems.

Validation of internal estimates.

185. Institutions must validate their internal estimates subject to the following requirements–

(a) institutions must have robust systems in place to validate the accuracy and consistency of rating systems, processes, and the estimation of all relevant risk parameters. The internal validation process must enable the institution to assess the performance of internal rating and risk estimation systems consistently and meaningfully;

(b) institutions must regularly compare realised default rates with estimated PDs for each grade and, where realised default rates are outside the expected range for that grade, institutions must specifically analyse the reasons for the deviation. Institutions using own estimates of LGDs and conversion factors must also perform analogous analysis for these estimates. Such comparisons must make use of historical data that cover as long a period as possible. The institution must

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

document the methods and data used in such comparisons. This analysis and documentation must be updated at least annually;

(c) institutions must also use other quantitative validation tools and comparisons with relevant external data sources. The analysis must be based on data that are appropriate to the portfolio, are updated regularly, and cover a relevant observation period. Institutions' internal assessments of the performance of their rating systems must be based on as long a period as possible;

(d) the methods and data used for quantitative validation must be consistent through time. Changes in estimation and validation methods and data (both data sources and periods covered) must be documented;

(e) institutions must have sound internal standards for situations where deviations in realised PDs, LGDs, conversion factors and total losses, where EL is used, from expectations, become significant enough to call the validity of the estimates into question. These standards must take account of business cycles and similar systematic variability in default experience. Where realised values continue to be higher than expected values, institutions must revise estimates upward to reflect their default and loss experience.

Own funds requirement and risk quantification.

186. For the purpose of calculating own funds requirements institutions must meet the following standards–

(a) the estimate of potential loss must be robust to adverse market movements relevant to the long-term risk profile of the institution's specific holdings. The data used to represent return distributions must reflect the longest sample period for which data is available and meaningful in representing the risk profile of the institution's specific equity exposures. The data used must be sufficient to provide conservative, statistically reliable and robust loss estimates that are not based purely on subjective or judgmental considerations. The shock employed must provide a conservative estimate of potential losses over a relevant long-term market or business cycle. The institution must combine empirical analysis of available data with adjustments based on a variety of factors in order to attain model outputs that achieve appropriate realism and conservatism. In constructing value at risk (VaR) models estimating potential quarterly losses, institutions may use quarterly data or convert shorter horizon period data to a quarterly equivalent using an analytically appropriate method supported by empirical evidence and through a well-developed and documented thought process and analysis. Such an approach must be applied conservatively and consistently over time. Where only

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

limited relevant data is available the institution must add appropriate margins of conservatism;

(b) the models used must capture adequately all of the material risks embodied in equity returns including both the general market risk and specific risk exposure of the institution's equity portfolio. The internal models must adequately explain historical price variation, capture both the magnitude and changes in the composition of potential concentrations, and be robust to adverse market environments. The population of risk exposures represented in the data used for estimation must be closely matched to or at least comparable with those of the institution's equity exposures;

(c) the internal model must be appropriate for the risk profile and complexity of an institution's equity portfolio. Where an institution has material holdings with values that are highly non-linear in nature the internal models must be designed to capture appropriately the risks associated with such instruments;

(d) mapping of individual positions to proxies, market indices, and risk factors must be plausible, intuitive, and conceptually sound;

(e) institutions must demonstrate through empirical analyses the appropriateness of risk factors, including their ability to cover both general and specific risk;

(f) the estimates of the return volatility of equity exposures must incorporate relevant and available data, information, and methods. Independently reviewed internal data or data from external sources including pooled data must be used;

(g) a rigorous and comprehensive stress-testing programme must be in place.

Risk management process and controls.

187. With regard to the development and use of internal models for own funds requirement purposes, institutions must establish policies, procedures, and controls to ensure the integrity of the model and modelling process. These policies, procedures, and controls must include the following–

(a) full integration of the internal model into the overall management information systems of the institution and in the management of the non-trading book equity portfolio. Internal models must be fully integrated into the institution's risk management infrastructure if they are particularly used in measuring and assessing equity portfolio performance including the risk-adjusted performance, allocating

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

economic capital to equity exposures and evaluating overall capital adequacy and the investment management process;

(b) established management systems, procedures, and control functions for ensuring the periodic and independent review of all elements of the internal modelling process, including approval of model revisions, vetting of model inputs, and review of model results, such as direct verification of risk computations. These reviews must assess the accuracy, completeness, and appropriateness of model inputs and results and focus on both finding and limiting potential errors associated with known weaknesses and identifying unknown model weaknesses. Such reviews may be conducted by an internal independent unit, or by an independent external third party;

(c) adequate systems and procedures for monitoring investment limits and the risk exposures of equity exposures;

(d) the units responsible for the design and application of the model must be functionally independent from the units responsible for managing individual investments;

(e) parties responsible for any aspect of the modelling process must be adequately qualified. Management must allocate sufficient skilled and competent resources to the modelling function.

Validation and documentation.

188. Institutions must have robust systems in place to validate the accuracy and consistency of their internal models and modelling processes. All material elements of the internal models and the modelling process and validation must be documented.

The validation and documentation of institutions' internal models and modelling processes must be subject to the following requirements–

(a) institutions must use the internal validation process to assess the performance of its internal models and processes in a consistent and meaningful way;

(b) the methods and data used for quantitative validation must be consistent over time. Changes in estimation and validation methods and changes to data sources and periods covered, must be documented;

(c) institutions must regularly compare actual equity returns computed using realised and unrealised gains and losses with modelled estimates. Such comparisons must

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

make use of historical data that cover as long a period as possible. The institution must document the methods and data used in such comparisons. This analysis and documentation must be updated at least annually;

(d) institutions must make use of other quantitative validation tools and comparisons with external data sources. The analysis must be based on data that are appropriate to the portfolio, are updated regularly, and cover a relevant observation period. Institutions' internal assessments of the performance of their models must be based on as long a period as possible;

(e) institutions must have sound internal standards for addressing situations where comparison of actual equity returns with the models estimates calls the validity of the estimates or of the models as such into question. These standards must take account of business cycles and similar systematic variability in equity returns. All adjustments made to internal models in response to model reviews must be documented and consistent with the institution's model review standards;

(f) the internal model and the modelling process must be documented, including the responsibilities of parties involved in the modelling, and the model approval and model review processes.

Corporate Governance.

189.(1) All material aspects of the rating and estimation processes must be approved by the institution's management body or a designated committee thereof and senior management. These parties must possess a general understanding of the rating systems of the institution and detailed comprehension of its associated management reports.

(2) Senior management must be subject to the following requirements–

(a) they must provide notice to the management body or a designated committee thereof of material changes or exceptions from established policies that will materially impact the operations of the institution's rating systems;

(b) they must have a good understanding of the rating systems designs and operations;

(c) they must ensure, on an ongoing basis that the rating systems are operating properly.

Senior management must be regularly informed by the credit risk control units about the performance of the rating process, areas needing improvement, and the status of efforts to improve previously identified deficiencies.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(3) Internal ratings-based analysis of the institution's credit risk profile must be an essential part of the management reporting to these parties. Reporting must include at least risk profile by grade, migration across grades, estimation of the relevant parameters per grade, and comparison of realised default rates, and to the extent that own estimates are used of realised LGDs and realised conversion factors against expectations and stress-test results. Reporting frequencies must depend on the significance and type of information and the level of the recipient.

Credit risk control.

190.(1) The credit risk control unit must be independent from the personnel and management functions responsible for originating or renewing exposures and report directly to senior management. The unit must be responsible for the design or selection, implementation, oversight and performance of the rating systems. It must regularly produce and analyse reports on the output of the rating systems.

(2) The areas of responsibility for the credit risk control unit or units must include–

(a) testing and monitoring grades and pools;

(b) production and analysis of summary reports of the institution's rating systems;

(c) implementing procedures to verify that grade and pool definitions are consistently applied across departments and geographic areas;

(d) reviewing and documenting any changes to the rating process, including the reasons for the changes;

(e) reviewing the rating criteria to evaluate if they remain predictive of risk. Changes to the rating process, criteria or individual rating parameters must be documented and retained;

(f) active participation in the design or selection, implementation and validation of models used in the rating process;

(g) oversight and supervision of models used in the rating process;

(h) ongoing review and alterations to models used in the rating process.

(3) Institutions using pooled data in accordance with Article 179(2) may outsource the following tasks–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) production of information relevant to testing and monitoring grades and pools;

(b) production of summary reports of the institution's rating systems;

(c) production of information relevant to a review of the rating criteria to evaluate if they remain predictive of risk;

(d) documentation of changes to the rating process, criteria or individual rating parameters;

(e) production of information relevant to ongoing review and alterations to models used in the rating process.

(4) Institutions making use of paragraph (3) must ensure that the GFSC have access to all relevant information from the third party that is necessary for examining compliance with the requirements and that the GFSC may perform on-site examinations to the same extent as within the institution.

Internal Audit.

191. Internal audit or another comparable independent auditing unit must review at least annually the institution's rating systems and its operations, including the operations of the credit function and the estimation of PDs, LGDs, ELs and conversion factors. Areas of review must include adherence to all applicable requirements.

CHAPTER 4
CREDIT RISK MITIGATION

Definitions.

192.(1) For the purposes of this Chapter, the following definitions must apply–

"lending institution" means the institution which has the exposure in question;

"secured lending transaction" means any transaction giving rise to an exposure secured by collateral which does not include a provision conferring upon the institution the right to receive margin at least daily;

"capital market-driven transaction" means any transaction giving rise to an exposure secured by collateral which includes a provision conferring upon the institution the right to receive margin at least daily;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

"underlying CIU" means a CIU in the shares or units of which another CIU has invested.

(2) For the purposes of this Chapter, references to "institutions" as issuers or eligible credit providers include undertakings established in third countries which would fall within the definition in Article 4 if they were established in Gibraltar.

Principles for recognising the effect of credit risk mitigation techniques.

193.(1) No exposure in respect of which an institution obtains credit risk mitigation must produce a higher risk-weighted exposure amount or expected loss amount than an otherwise identical exposure in respect of which an institution has no credit risk mitigation.

(2) Where the risk-weighted exposure amount already takes account of credit protection under Chapter 2 or Chapter 3, as applicable, institutions must not take into account that credit protection in the calculations under this Chapter.

(3) Where the provisions in Articles 195 to 217 are met, institutions may amend the calculation of risk-weighted exposure amounts under the Standardised Approach and the calculation of risk-weighted exposure amounts and expected loss amounts under the IRB Approach in accordance with the provisions of Articles 218 to 241.

(4) Institutions must treat cash, securities or commodities purchased, borrowed or received under a repurchase transaction or securities or commodities lending or borrowing transaction as collateral.

(5) Where an institution calculating risk-weighted exposure amounts under the Standardised Approach has more than one form of credit risk mitigation covering a single exposure it must do both of the following–

(a) subdivide the exposure into parts covered by each type of credit risk mitigation tool;

(b) calculate the risk-weighted exposure amount for each part obtained in sub-paragraph (a) separately in accordance with the provisions of Chapter 2 and this Chapter.

(6) When an institution calculating risk-weighted exposure amounts under the Standardised Approach covers a single exposure with credit protection provided by a single protection provider and that protection has differing maturities, it must do both of the following–

(a) subdivide the exposure into parts covered by each credit risk mitigation tool;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(b) calculate the risk-weighted exposure amount for each part obtained in sub-paragraph (a) separately in accordance with the provisions of Chapter 2 and this Chapter.

Principles governing the eligibility of credit risk mitigation techniques.

194.(1) The technique used to provide the credit protection together with the actions and steps taken and procedures and policies implemented by the lending institution must be such as to result in credit protection arrangements which are legally effective and enforceable in all relevant jurisdictions.

The lending institution must provide, upon request of the GFSC, the most recent version of the independent, written and reasoned legal opinion or opinions that it used to establish whether its credit protection arrangement or arrangements meet the condition laid down in the first sub-paragraph.

(2) The lending institution must take all appropriate steps to ensure the effectiveness of the credit protection arrangement and to address the risks related to that arrangement.

(3) Institutions may recognise funded credit protection in the calculation of the effect of credit risk mitigation only where the assets relied upon for protection meet both of the following conditions–

(a) they are included in the list of eligible assets set out in Articles 197 to 200, as applicable;

(b) they are sufficiently liquid and their value over time sufficiently stable to provide appropriate certainty as to the credit protection achieved having regard to the approach used to calculate risk-weighted exposure amounts and to the degree of recognition allowed.

(4) Institutions may recognise funded credit protection in the calculation of the effect of credit risk mitigation only where the lending institution has the right to liquidate or retain, in a timely manner, the assets from which the protection derives in the event of the default, insolvency or bankruptcy — or other credit event set out in the transaction documentation — of the obligor and, where applicable, of the custodian holding the collateral. The degree of correlation between the value of the assets relied upon for protection and the credit quality of the obligor must not be too high.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(5) In the case of unfunded credit protection, a protection provider must qualify as an eligible protection provider only where the protection provider is included in the list of eligible protection providers set out in Article 201 or 202, as applicable.

(6) In the case of unfunded credit protection, a protection agreement must qualify as an eligible protection agreement only where it meets both the following conditions–

(a) it is included in the list of eligible protection agreements set out in Articles 203 and 204(1);

(b) it is legally effective and enforceable in the relevant jurisdictions, to provide appropriate certainty as to the credit protection achieved having regard to the approach used to calculate risk-weighted exposure amounts and to the degree of recognition allowed;

(c) the protection provider meets the criteria laid down in paragraph (5).

(7) Credit protection must comply with the requirements set out in Articles 205 to 217, as applicable.

(8) An institution must be able to demonstrate to the GFSC that it has adequate risk management processes to control those risks to which it may be exposed as a result of carrying out credit risk mitigation practices.

(9) Despite the fact that credit risk mitigation has been taken into account for the purposes of calculating risk-weighted exposure amounts and, where applicable, expected loss amounts, institutions must continue to undertake a full credit risk assessment of the underlying exposure and be in a position to demonstrate the fulfilment of this requirement to the GFSC.

In the case of repurchase transactions and securities lending or commodities lending or borrowing transactions the underlying exposure must, for the purposes of this paragraph only, be deemed to be the net amount of the exposure.

(10) [Not used]

Eligible forms of credit risk mitigation

On-balance sheet netting.

195. An institution may use on-balance sheet netting of mutual claims between itself and its counterparty as an eligible form of credit risk mitigation.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Without prejudice to Article 196, eligibility is limited to reciprocal cash balances between the institution and the counterparty. Institutions may amend risk-weighted exposure amounts and, as relevant, expected loss amounts only for loans and deposits that they have received themselves and that are subject to an on-balance sheet netting agreement.

Master netting agreements covering repurchase transactions or securities or commodities lending or borrowing transactions or other capital market-driven transactions.

196. Institutions adopting the Financial Collateral Comprehensive Method set out in Article 223 may take into account the effects of bilateral netting contracts covering repurchase transactions, securities or commodities lending or borrowing transactions, or other capital market-driven transactions with a counterparty. Without prejudice to Article 299, the collateral taken and securities or commodities borrowed within such agreements or transactions must comply with the eligibility requirements for collateral set out in Articles 197 and 198.

Eligibility of collateral under all approaches and methods.

197.(1) Institutions may use the following items as eligible collateral under all approaches and methods–

(a) cash on deposit with, or cash assimilated instruments held by, the lending institution;

(b) debt securities issued by central governments or central banks, which securities have a credit assessment by an ECAI or export credit agency recognised as eligible for the purposes of Chapter 2 which has been determined by the GFSC to be associated with credit quality step 4 or above under the rules for the risk weighting of exposures to central governments and central banks under Chapter 2;

(c) debt securities issued by institutions or investment firms, which securities have a credit assessment by an ECAI which has been determined by the GFSC to be associated with credit quality step 3 or above under the rules for the risk weighting of exposures to institutions under Chapter 2;

(d) debt securities issued by other entities which securities have a credit assessment by an ECAI which has been determined by the GFSC to be associated with credit quality step 3 or above under the rules for the risk weighting of exposures to corporates under Chapter 2;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(e) debt securities with a short-term credit assessment by an ECAI which has been determined by the GFSC to be associated with credit quality step 3 or above under the rules for the risk weighting of short term exposures under Chapter 2;

(f) equities or convertible bonds that are included in a main index;

(g) gold;

(h) securitisation positions that are not resecuritisation positions and which are subject to a 100% risk weight or lower in accordance with Article 261 to Article 264.

(2) For the purposes of paragraph (1)(b), "debt securities issued by central governments or central banks" must include all the following–

(a) debt securities issued by regional governments or local authorities, exposures to which are treated as exposures to the central government in whose jurisdiction they are established under Article 115(2);

(b) debt securities issued by public sector entities which are treated as exposures to central governments in accordance with Article 116(4);

(c) debt securities issued by multilateral development banks to which a 0% risk weight is assigned under Article 117(2);

(d) debt securities issued by international organisations which are assigned a 0% risk weight under Article 118.

(3) For the purposes of paragraph (1)(c), "debt securities issued by institutions" must include all the following–

(a) debt securities issued by regional governments or local authorities other than those debt securities referred to in paragraph (2)(a);

(b) debt securities issued by public sector entities, exposures to which are treated in accordance with Article 116(1) and (2);

(c) debt securities issued by multilateral development banks other than those to which a 0% risk weight is assigned under Article 117(2).

(4) An institution may use debt securities that are issued by other institutions or investment firms and that do not have a credit assessment by an ECAI as eligible collateral where those debt securities fulfil all the following criteria–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) they are listed on a recognised exchange;

(b) they qualify as senior debt;

(c) all other rated issues by the issuing institution of the same seniority have a credit assessment by an ECAI which has been determined by the GFSC to be associated with credit quality step 3 or above under the rules for the risk weighting of exposures to institutions or short term exposures under Chapter 2;

(d) the lending institution has no information to suggest that the issue would justify a credit assessment below that indicated in sub-paragraph (c);

(e) the market liquidity of the instrument is sufficient for these purposes.

(5) Institutions may use units or shares in CIUs as eligible collateral where all the following conditions are satisfied–

(a) the units or shares have a daily public price quote;

(b) the CIUs are limited to investing in instruments that are eligible for recognition under paragraphs (1) and (4);

(c) the CIUs meet the conditions laid down in Article 132(3).

Where a CIU invests in shares or units of another CIU, the conditions laid down in sub-paragraphs (a) to (c) must apply equally to any such underlying CIU.

The use by a CIU of derivative instruments to hedge permitted investments must not prevent units or shares in that undertaking from being eligible as collateral.

(6) For the purposes of paragraph (5), where a CIU ("the original CIU") or any of its underlying CIUs are not limited to investing in instruments that are eligible under paragraphs 1 and 4, institutions may use units or shares in that CIU as collateral to an amount equal to the value of the eligible assets held by that CIU under the assumption that that CIU or any of its underlying CIUs have invested in non-eligible assets to the maximum extent allowed under their respective mandates.

Where any underlying CIU has underlying CIUs of its own, institutions may use units or shares in the original CIU as eligible collateral if they apply the methodology laid down in the first sub-paragraph.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Where non-eligible assets can have a negative value due to liabilities or contingent liabilities resulting from ownership, institutions must do both of the following–

(a) calculate the total value of the non-eligible assets;

(b) where the amount obtained under sub-paragraph (a) is negative, subtract the absolute value of that amount from the total value of the eligible assets.

(7) With regard to paragraph (1)(b) to (e), where a security has two credit assessments by ECAIs, institutions must apply the less favourable assessment. Where a security has more than two credit assessments by ECAIs, institutions must apply the two most favourable assessments. Where the two most favourable credit assessments are different, institutions must apply the less favourable of the two.

(8) [Not used]

Additional eligibility of collateral under the Financial Collateral Comprehensive Method.

198.(1) In addition to the collateral established in Article 197, where an institution uses the Financial Collateral Comprehensive Method set out in Article 223, that institution may use the following items as eligible collateral–

(a) equities or convertible bonds not included in a main index but traded on a recognised exchange;

(b) units or shares in CIUs where both the following conditions are met–

(i) the units or shares have a daily public price quote;

(ii) the CIU is limited to investing in instruments that are eligible for recognition under Article 197(1) and (4) and the items mentioned in sub-paragraph (a).

In the case a CIU invests in units or shares of another CIU, conditions sub-paragraphs (a) and (b) equally apply to any such underlying CIU.

The use by a CIU of derivative instruments to hedge permitted investments must not prevent units or shares in that undertaking from being eligible as collateral.

(2) Where the CIU or any underlying CIU are not limited to investing in instruments that are eligible for recognition under Article 197(1) and (4) and the items mentioned in paragraph

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(1)(a), institutions may use units or shares in that CIU as collateral to an amount equal to the value of the eligible assets held by that CIU under the assumption that that CIU or any of its underlying CIUs have invested in non-eligible assets to the maximum extent allowed under their respective mandates.

Where non-eligible assets can have a negative value due to liabilities or contingent liabilities resulting from ownership, institutions must do both of the following–

(a) calculate the total value of the non-eligible assets;

(b) where the amount obtained under sub-paragraph (a) is negative, subtract the absolute value of that amount from the total value of the eligible assets.

Additional eligibility for collateral under the IRB Approach.

199.(1) In addition to the collateral referred to in Articles 197 and 198, institutions that calculate risk-weighted exposure amounts and expected loss amounts under the IRB Approach may also use the following forms of collateral–

(a) immovable property collateral in accordance with paragraphs (2), (3) and (4);

(b) receivables in accordance with paragraph (5);

(c) other physical collateral in accordance with paragraphs (6) and (8);

(d) leasing in accordance with paragraph (7).

(2) Unless otherwise specified under Article 124(2), institutions may use as eligible collateral residential property which is or will be occupied or let by the owner, or the beneficial owner in the case of personal investment companies, and commercial immovable property, including offices and other commercial premises, where both the following conditions are met–

(a) the value of the property does not materially depend upon the credit quality of the obligor. Institutions may exclude situations where purely macro-economic factors affect both the value of the property and the performance of the borrower from their determination of the materiality of such dependence;

(b) the risk of the borrower does not materially depend upon the performance of the underlying property or project, but on the underlying capacity of the borrower to repay the debt from other sources, and as a consequence the repayment of the facility does not materially depend on any cash flow generated by the underlying property serving as collateral.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(3) Institutions may derogate from paragraph (2)(b) for exposures secured by residential property situated in Gibraltar, where the competent authority has published evidence showing that a well-developed and long-established residential property market is present with loss rates that do not exceed any of the following limits–

(a) losses stemming from loans collateralised by residential property up to 80% of the market value or 80% of the mortgage lending value, unless otherwise provided under Article 124(2), do not exceed 0.3% of the outstanding loans collateralised by residential property in any given year;

(b) overall losses stemming from loans collateralised by residential property do not exceed 0.5% of the outstanding loans collateralised by residential property in any given year.

Where either of the conditions in sub-paragraphs (a) and (b) is not met in a given year, institutions must not use the treatment set out in that sub-paragraph until both conditions are satisfied in a subsequent year.

(4) Institutions may derogate from paragraph (2)(b) for commercial immovable property situated in Gibraltar, where the competent authority has published evidence showing that a well-developed and long-established commercial immovable property market is present with loss rates that do not exceed any of the following limits–

(a) losses stemming from loans collateralised by commercial immovable property up to 50% of the market value or 60% of the mortgage lending value do not exceed 0.3% of the outstanding loans collateralised by commercial immovable property in any given year;

(b) overall losses stemming from loans collateralised by commercial immovable property do not exceed 0.5% of the outstanding loans collateralised by commercial immovable property in any given year.

Where either of the conditions in sub-paragraphs (a) and (b) is not met in a given year, institutions must not use the treatment set out in that sub-paragraph until both conditions are satisfied in a subsequent year.

(5) Institutions may use as eligible collateral amounts receivable linked to a commercial transaction or transactions with an original maturity of less than or equal to one year. Eligible receivables do not include those associated with securitisations, sub-participations or credit derivatives or amounts owed by affiliated parties.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(6) The GFSC must permit an institution to use as eligible collateral physical collateral of a type other than those indicated in paragraphs (2), (3) and (4) where all the following conditions are met–

(a) there are liquid markets, evidenced by frequent transactions taking into account the asset type, for the disposal of the collateral in an expeditious and economically efficient manner. Institutions must carry out the assessment of this condition periodically and where information indicates material changes in the market;

(b) there are well-established, publicly available market prices for the collateral. Institutions may consider market prices as well-established where they come from reliable sources of information such as public indices and reflect the price of the transactions under normal conditions. Institutions may consider market prices as publicly available, where these prices are disclosed, easily accessible, and obtainable regularly and without any undue administrative or financial burden;

(c) the institution analyses the market prices, time and costs required to realise the collateral and the realised proceeds from the collateral;

(d) the institution demonstrates that the realised proceeds from the collateral are not below 70% of the collateral value in more than 10% of all liquidations for a given type of collateral. Where there is material volatility in the market prices, the institution demonstrates to the satisfaction of the GFSC that its valuation of the collateral is sufficiently conservative.

Institutions must document the fulfilment of the conditions specified in sub-paragraphs (a) to (d) and those specified in Article 210.

(7) Subject to the provisions of Article 230(2), where the requirements set out in Article 211 are met, exposures arising from transactions whereby an institution leases property to a third party may be treated in the same manner as loans collateralised by the type of property leased.

(8) The GFSC may publish a list of types of physical collateral for which institutions can assume that the conditions referred to in paragraph (6)(a) and (b) are met.

Other funded credit protection.

200. Institutions may use the following other funded credit protection as eligible collateral–

(a) cash on deposit with, or cash assimilated instruments held by, a third party institution in a non-custodial arrangement and pledged to the lending institution;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(b) life insurance policies pledged to the lending institution;

(c) instruments issued by a third-party institution or investment firm which are to be repurchased by that institution or investment firm on request.

Eligibility of protection providers under all approaches.

201.(1) Institutions may use the following parties as eligible providers of unfunded credit protection–

(a) central governments and central banks;

(b) regional governments or local authorities;

(c) multilateral development banks;

(d) international organisations exposures to which a 0% risk weight under Article 117 is assigned;

(e) public sector entities, claims on which are treated in accordance with Article 116;

(f) institutions, and financial institutions for which exposures to the financial institution are treated as exposures to institutions in accordance with Article 119(5);

(g) other corporate entities, including parent undertakings, subsidiaries and affiliated corporate entities of the institution, where either of the following conditions is met–

(i) those other corporate entities have a credit assessment by an ECAI;

(ii) in the case of institutions calculating risk-weighted exposure amounts and expected loss amounts under the IRB Approach, those other corporate entities do not have a credit assessment by a recognised ECAI and are internally rated by the institution;

(h) qualifying central counterparties.

(2) Where institutions calculate risk-weighted exposure amounts and expected loss amounts under the IRB Approach, to be eligible as a provider of unfunded credit protection a guarantor must be internally rated by the institution in accordance with Articles 169 to 191.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

The GFSC must publish and maintain the list of those financial institutions that are eligible providers of unfunded credit protection under paragraph (1)(f), or the guiding criteria for identifying such eligible providers of unfunded credit protection, together with a description of the applicable prudential requirements.

Eligibility of protection providers under the IRB Approach which qualify for the treatment set out in Article 153(3).

202. An institution may use institutions, investment firms, insurance and reinsurance undertakings and export credit agencies as eligible providers of unfunded credit protection which qualify for the treatment set out in Article 153(3) where they meet all the following conditions–

(a) they have sufficient expertise in providing unfunded credit protection;

(b) they are regulated in a manner equivalent to the rules laid down in these Standards, or had, at the time the credit protection was provided, a credit assessment by a recognised ECAI which had been determined by the GFSC to be associated with credit quality step 3 or above in accordance with the rules for the risk weighting of exposures to corporates set out in Chapter 2;

(c) they had, at the time the credit protection was provided, or for any period of time thereafter, an internal rating with a PD equivalent to or lower than that associated with credit quality step 2 or above in accordance with the rules for the risk weighting of exposures to corporates set out in Chapter 2;

(d) they have an internal rating with a PD equivalent to or lower than that associated with credit quality step 3 or above in accordance with the rules for the risk weighting of exposures to corporates set out in Chapter 2.

For the purpose of this Article, credit protection provided by export credit agencies must not benefit from any explicit central government counter-guarantee.

Eligibility of guarantees as unfunded credit protection.

203. Institutions may use guarantees as eligible unfunded credit protection.

Eligible types of credit derivatives.

204.(1) Institutions may use the following types of credit derivatives, and instruments that may be composed of such credit derivatives or that are economically effectively similar, as eligible credit protection–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) credit default swaps;

(b) total return swaps;

(c) credit linked notes to the extent of their cash funding.

Where an institution buys credit protection through a total return swap and records the net payments received on the swap as net income, but does not record the offsetting deterioration in the value of the asset that is protected either through reductions in fair value or by an addition to reserves, that credit protection does not qualify as eligible credit protection.

(2) Where an institution conducts an internal hedge using a credit derivative, in order for the credit protection to qualify as eligible credit protection for the purposes of this Chapter, the credit risk transferred to the trading book must be transferred out to a third party or parties.

Where an internal hedge has been conducted in accordance with the first sub-paragraph and the requirements in this Chapter have been met, institutions must apply the rules set out in Articles 218 to 241 for the calculation of risk-weighted exposure amounts and expected loss amounts where they acquire unfunded credit protection.

Eligible types of equity derivatives.

204A.(1) Institutions may use equity derivatives which are total return swaps or economically effectively similar, as eligible credit protection only for the purpose of conducting internal hedges.

Where an institution buys credit protection through a total return swap and records the net payments received on the swap as net income, but does not record the offsetting deterioration in the value of the asset that is protected either through reductions in fair value or by an addition to reserves, that credit protection must not qualify as eligible credit protection.

(2) Where an institution conducts an internal hedge using an equity derivative, in order for the internal hedge to qualify as eligible credit protection for the purposes of this Chapter, the credit risk transferred to the trading book must be transferred out to a third party or parties.

Where an internal hedge has been conducted in accordance with the first sub-paragraph and the requirements in this Chapter have been met, institutions must apply the rules set out in Articles 218 to 241 for the calculation of risk-weighted exposure amounts and expected loss amounts where they acquire unfunded credit protection.

Requirements

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Requirements for on-balance sheet netting agreements other than master netting agreements referred to in Article 206.

205. On-balance sheet netting agreements other than master netting agreements referred to in Article 206 must qualify as an eligible form of credit risk mitigation where all the following conditions are met–

(a) those agreements are legally effective and enforceable in all relevant jurisdictions, including in the event of the insolvency or bankruptcy of a counterparty;

(b) institutions are able to determine at any time the assets and liabilities that are subject to those agreements;

(c) institutions monitor and control the risks associated with the termination of the credit protection on an ongoing basis;

(d) institutions monitor and control the relevant exposures on a net basis and do so on an ongoing basis.

Requirements for master netting agreements covering repurchase transactions or securities or commodities lending or borrowing transactions or other capital market driven transactions.

206. Master netting agreements covering repurchase transactions, securities or commodities lending or borrowing transactions or other capital market driven transactions must qualify as an eligible form of credit risk mitigation where the collateral provided under those agreements meets all the requirements laid down in Article 207(2) to (4) and where all the following conditions are met–

(a) they are legally effective and enforceable in all relevant jurisdictions, including in the event of the bankruptcy or insolvency of the counterparty;

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

(c) they provide for the netting of gains and losses on transactions closed out under an agreement so that a single net amount is owed by one party to the other.

Requirements for financial collateral.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

207.(1) Under all approaches and methods, financial collateral and gold must qualify as eligible collateral where all the requirements laid down in paragraphs (2) to (4) are met.

(2) The credit quality of the obligor and the value of the collateral must not have a material positive correlation. Where the value of the collateral is reduced significantly, this must not alone imply a significant deterioration of the credit quality of the obligor. Where the credit quality of the obligor becomes critical, this must not alone imply a significant reduction in the value of the collateral.

Securities issued by the obligor, or any related group entity, must not qualify as eligible collateral. However, the obligor's own issues of covered bonds falling within the terms of Article 129 qualify as eligible collateral when they are posted as collateral for a repurchase transaction, if they comply with the condition set out in the first sub-paragraph.

(3) Institutions must fulfil any contractual and statutory requirements in respect of, and take all steps necessary to ensure, the enforceability of the collateral arrangements under the law applicable to their interest in the collateral.

Institutions must have conducted sufficient legal review confirming the enforceability of the collateral arrangements in all relevant jurisdictions. They must re-conduct such review as necessary to ensure continuing enforceability.

(4) Institutions must fulfil all the following operational requirements–

(a) they must properly document the collateral arrangements and have in place clear and robust procedures for the timely liquidation of collateral;

(b) they must use robust procedures and processes to control risks arising from the use of collateral, including risks of failed or reduced credit protection, valuation risks, risks associated with the termination of the credit protection, concentration risk arising from the use of collateral and the interaction with the institution's overall risk profile;

(c) they must have in place documented policies and practices concerning the types and amounts of collateral accepted;

(d) they must calculate the market value of the collateral, and revalue it accordingly, at least once every six months and whenever they have reason to believe that a significant decrease in the market value of the collateral has occurred;

(e) where the collateral is held by a third party, they must take reasonable steps to ensure that the third party segregates the collateral from its own assets;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(f) they must ensure that they devote sufficient resources to the orderly operation of margin agreements with OTC derivatives and securities-financing counterparties, as measured by the timeliness and accuracy of their outgoing margin calls and response time to incoming margin calls;

(g) they must have in place collateral management policies to control, monitor and report the following–

(i) the risks to which margin agreements expose them;

(ii) the concentration risk to particular types of collateral assets;

(iii) the reuse of collateral including the potential liquidity shortfalls resulting from the reuse of collateral received from counterparties;

(iv) the surrender of rights on collateral posted to counterparties.

(5) In addition to meeting all the requirements set out in paragraphs (2) to (4), for financial collateral to qualify as eligible collateral under the Financial Collateral Simple Method the residual maturity of the protection must be at least as long as the residual maturity of the exposure.

Requirements for immovable property collateral.

208.(1) Immovable property must qualify as eligible collateral only where all the requirements laid down in paragraphs (2) to (5) are met.

(2) The following requirements on legal certainly must be met–

(a) a mortgage or charge is enforceable in all jurisdictions which are relevant at the time of the conclusion of the credit agreement and must be properly filed on a timely basis;

(b) all legal requirements for establishing the pledge have been fulfilled;

(c) the protection agreement and the legal process underpinning it enable the institution to realise the value of the protection within a reasonable timeframe.

(3) The following requirements on monitoring of property values and on property valuation must be met–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) institutions monitor the value of the property on a frequent basis and at a minimum once every year for commercial immovable property and once every three years for residential property. Institutions carry out more frequent monitoring where the market is subject to significant changes in conditions;

(b) the property valuation is reviewed when information available to institutions indicates that the value of the property may have declined materially relative to general market prices and that review is carried out by a valuer who possesses the necessary qualifications, ability and experience to execute a valuation and who is independent from the credit decision process. For loans exceeding €3 million or 5% of the own funds of an institution, the property valuation must be reviewed by such valuer at least every three years.

Institutions may use statistical methods to monitor the value of the immovable property and to identify immovable property that needs revaluation.

(4) Institutions must clearly document the types of residential property and commercial immovable property they accept and their lending policies in this regard.

(5) Institutions must have in place procedures to monitor that the immovable property taken as credit protection is adequately insured against the risk of damage.

Requirements for receivables.

209.(1) Receivables must qualify as eligible collateral where all the requirements laid down in paragraphs (2) and (3) are met.

(2) The following requirements on legal certainty must be met–

(a) the legal mechanism by which the collateral is provided to a lending institution must be robust and effective and ensure that that institution has clear rights over the collateral including the right to the proceeds from the sale of the collateral;

(b) institutions must take all steps necessary to fulfil local requirements in respect of the enforceability of security interest. Lending institutions must have a first priority claim over the collateral although such claims may still be subject to the claims of preferential creditors provided for in legislative provisions;

(c) institutions must have conducted sufficient legal review confirming the enforceability of the collateral arrangements in all relevant jurisdictions;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(d) institutions must properly document their collateral arrangements and must have in place clear and robust procedures for the timely collection of collateral;

(e) institutions must have in place procedures that ensure that any legal conditions required for declaring the default of a borrower and timely collection of collateral are observed;

(f) in the event of a borrower's financial distress or default, institutions must have legal authority to sell or assign the receivables to other parties without consent of the receivables obligors.

(3) The following requirements on risk management must be met–

(a) an institution must have in place a sound process for determining the credit risk associated with the receivables. Such a process must include analyses of a borrower's business and industry and the types of customers with whom that borrower does business. Where the institution relies on its borrowers to ascertain the credit risk of the customers, the institution must review the borrowers' credit practices to ascertain their soundness and credibility;

(b) the difference between the amount of the exposure and the value of the receivables must reflect all appropriate factors, including the cost of collection, concentration within the receivables pool pledged by an individual borrower, and potential concentration risk within the institution's total exposures beyond that controlled by the institution's general methodology. Institutions must maintain a continuous monitoring process appropriate to the receivables. They must also review, on a regular basis, compliance with loan covenants, environmental restrictions, and other legal requirements;

(c) receivables pledged by a borrower must be diversified and not be unduly correlated with that borrower. Where there is material positive correlation, institutions must take into account the attendant risks in the setting of margins for the collateral pool as a whole;

(d) institutions must not use receivables from affiliates of a borrower, including subsidiaries and employees, as eligible credit protection;

(e) institution must have in place a documented process for collecting receivable payments in distressed situations. Institutions must have in place the requisite facilities for collection even when they normally rely on their borrowers for collections.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Requirements for other physical collateral.

210. Physical collateral other than immovable property collateral must qualify as eligible collateral under the IRB Approach where all the following conditions are met–

(a) the collateral arrangement under which the physical collateral is provided to an institution must be legally effective and enforceable in all relevant jurisdictions and must enable that institution to realise the value of the collateral within a reasonable timeframe;

(b) with the sole exception of permissible first priority claims referred to in Article 209(2)(b), only first liens on, or charges over, collateral must qualify as eligible collateral and an institution must have priority over all other lenders to the realised proceeds of the collateral;

(c) institutions must monitor the value of the collateral on a frequent basis and at least once every year. Institutions must carry out more frequent monitoring where the market is subject to significant changes in conditions;

(d) the loan agreement must include detailed descriptions of the collateral as well as detailed specifications of the manner and frequency of revaluation;

(e) institutions must clearly document in internal credit policies and procedures available for examination the types of physical collateral they accept and the policies and practices they have in place in respect of the appropriate amount of each type of collateral relative to the exposure amount;

(f) institutions' credit policies with regard to the transaction structure must address the following–

(i) appropriate collateral requirements relative to the exposure amount;

(ii) the ability to liquidate the collateral readily;

(iii) the ability to establish objectively a price or market value;

(iv) the frequency with which the value can readily be obtained, including a professional appraisal or valuation;

(v) the volatility or a proxy of the volatility of the value of the collateral;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(g) when conducting valuation and revaluation, institutions must take fully into account any deterioration or obsolescence of the collateral, paying particular attention to the effects of the passage of time on fashion- or date-sensitive collateral;

(h) institutions must have the right to physically inspect the collateral. They must also have in place policies and procedures addressing their exercise of the right to physical inspection;

(i) the collateral taken as protection must be adequately insured against the risk of damage and institutions must have in place procedures to monitor this.

Requirements for treating lease exposures as collateralised.

211. Institutions must treat exposures arising from leasing transactions as collateralised by the type of property leased, where all the following conditions are met–

(a) the conditions set out in Article 208 or 210, as applicable, for the type of property leased to qualify as eligible collateral are met;

(b) the lessor has in place robust risk management with respect to the use to which the leased asset is put, its location, its age and the planned duration of its use, including appropriate monitoring of the value of the security;

(c) the lessor has legal ownership of the asset and is able to exercise its rights as owner in a timely fashion;

(d) where this has not already been ascertained in calculating the LGD level, the difference between the value of the unamortised amount and the market value of the security is not so large as to overstate the credit risk mitigation attributed to the leased assets.

Requirements for other funded credit protection.

212.(1) Cash on deposit with, or cash assimilated instruments held by, a third party institution must be eligible for the treatment set out in Article 232(1), where all the following conditions are met–

(a) the borrower's claim against the third party institution is openly pledged or assigned to the lending institution and such pledge or assignment is legally effective and enforceable in all relevant jurisdictions and is unconditional and irrevocable;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(b) the third party institution is notified of the pledge or assignment;

(c) as a result of the notification, the third party institution is able to make payments solely to the lending institution or to other parties only with the lending institution's prior consent.

(2) Life insurance policies pledged to the lending institution must qualify as eligible collateral where all the following conditions are met–

(a) the life insurance policy is openly pledged or assigned to the lending institution;

(b) the company providing the life insurance is notified of the pledge or assignment and, as a result of the notification, may not pay amounts payable under the contract without the prior consent of the lending institution;

(c) the lending institution has the right to cancel the policy and receive the surrender value in the event of the default of the borrower;

(d) the lending institution is informed of any non-payments under the policy by the policy-holder;

(e) the credit protection is provided for the maturity of the loan. Where this is not possible because the insurance relationship ends before the loan relationship expires, the institution must ensure that the amount deriving from the insurance contract serves the institution as security until the end of the duration of the credit agreement;

(f) the pledge or assignment is legally effective and enforceable in all jurisdictions which are relevant at the time of the conclusion of the credit agreement;

(g) the surrender value is declared by the company providing the life insurance and is non-reducible;

(h) the surrender value is to be paid by the company providing the life insurance in a timely manner upon request;

(i) the surrender value must not be requested without the prior consent of the institution;

(j) the company providing the life insurance is an insurance undertaking or reinsurance undertaking or is subject to supervision by a competent authority of a

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

third country which applies supervisory and regulatory arrangements at least equivalent to those applied in Gibraltar.

Requirements common to guarantees and credit derivatives.

213.(1) Subject to Article 214(1), credit protection deriving from a guarantee or credit derivative must qualify as eligible unfunded credit protection where all the following conditions are met–

(a) the credit protection is direct;

(b) the extent of the credit protection is clearly defined and incontrovertible;

(c) the credit protection contract does not contain any clause, the fulfilment of which is outside the direct control of the lender, that–

(i) would allow the protection provider to cancel the protection unilaterally;

(ii) would increase the effective cost of protection as a result of a deterioration in the credit quality of the protected exposure;

(iii) could prevent the protection provider from being obliged to pay out in a timely manner in the event that the original obligor fails to make any payments due, or when the leasing contract has expired for the purposes of recognising guaranteed residual value under Articles 134(7) and 166(4);

(iv) could allow the maturity of the credit protection to be reduced by the protection provider;

(d) the credit protection contract is legally effective and enforceable in all jurisdictions which are relevant at the time of the conclusion of the credit agreement.

(2) An institution must demonstrate to the GFSC that it has in place systems to manage potential concentration of risk arising from its use of guarantees and credit derivatives. An institution must be able to demonstrate to the satisfaction of the GFSC how its strategy in respect of its use of credit derivatives and guarantees interacts with its management of its overall risk profile.

(3) An institution must fulfil any contractual and statutory requirements in respect of, and take all steps necessary to ensure, the enforceability of its unfunded credit protection under the law applicable to its interest in the credit protection.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

An institution must have conducted sufficient legal review confirming the enforceability of the unfunded credit protection in all relevant jurisdictions. It must repeat such review as necessary to ensure continuing enforceability.

Sovereign and other public sector counter-guarantees.

214.(1) Institutions may treat the exposures referred to in paragraph (2) as protected by a guarantee provided by the entities listed in that paragraph, if all the following conditions are satisfied–

(a) the counter-guarantee covers all credit risk elements of the claim;

(b) both the original guarantee and the counter-guarantee meet the requirements for guarantees set out in Articles 213 and 215(1), except that the counter-guarantee need not be direct;

(c) the cover is robust and nothing in the historical evidence suggests that the coverage of the counter-guarantee is less than effectively equivalent to that of a direct guarantee by the entity in question.

(2) The treatment set out in paragraph (1) must apply to exposures protected by a guarantee which is counter-guaranteed by any of the following entities–

(a) a central government or a central bank;

(b) a regional government or a local authority;

(c) a public sector entity, claims on which are treated as claims on the central government in accordance with Article 116(4);

(d) a multilateral development bank or an international organisation, to which a 0% risk weight is assigned under or by virtue of Articles 117(2) and 118 respectively;

(e) a public sector entity, claims on which are treated in accordance with Article 116(1) and (2).

(3) Institutions must apply the treatment set out in paragraph (1) also to an exposure which is not counter-guaranteed by any entity listed in paragraph (2) where that exposure's counter-guarantee is in turn directly guaranteed by one of those entities and the conditions listed in paragraph (1) are satisfied.

Additional requirements for guarantees.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

215.(1) Guarantees must qualify as eligible unfunded credit protection where all the conditions in Article 213 and all the following conditions are met–

(a) on the qualifying default of or non-payment by the counterparty, the lending institution has the right to pursue, in a timely manner, the guarantor for any monies due under the claim in respect of which the protection is provided and the payment by the guarantor must not be subject to the lending institution first having to pursue the obligor;

In the case of unfunded credit protection covering residential mortgage loans, the requirements in Article 213(1)(c)(iii) and in the first sub-paragraph have only to be satisfied within 24 months;

(b) the guarantee is an explicitly documented obligation assumed by the guarantor;

(c) either of the following conditions is met–

(i) the guarantee covers all types of payments the obligor is expected to make in respect of the claim;

(ii) where certain types of payment are excluded from the guarantee, the lending institution has adjusted the value of the guarantee to reflect the limited coverage.

(2) In the case of guarantees provided in the context of mutual guarantee schemes or provided by or counter-guaranteed by entities listed in Article 214(2), the requirements in paragraph (1)(a) must be considered to be satisfied where either of the following conditions is met–

(a) the lending institution has the right to obtain in a timely manner a provisional payment by the guarantor that meets both the following conditions–

(i) it represents a robust estimate of the amount of the loss, including losses resulting from the non-payment of interest and other types of payment which the borrower is obliged to make, that the lending institution is likely to incur;

(ii) it is proportional to the coverage of the guarantee;

(b) the lending institution can demonstrate to the satisfaction of the GFSC that the effects of the guarantee, which must also cover losses resulting from the non-

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

payment of interest and other types of payments which the borrower is obliged to make, justify such treatment.

Additional requirements for credit derivatives.

216.(1) Credit derivatives must qualify as eligible unfunded credit protection where all the conditions in Article 213 and all the following conditions are met–

(a) the credit events specified in the credit derivative contract include–

(i) the failure to pay the amounts due under the terms of the underlying obligation that are in effect at the time of such failure, with a grace period that is equal to or shorter than the grace period in the underlying obligation;

(ii) the bankruptcy, insolvency or inability of the obligor to pay its debts, or its failure or admission in writing of its inability generally to pay its debts as they become due, and analogous events;

(iii) the restructuring of the underlying obligation involving forgiveness or postponement of principal, interest or fees that results in a credit loss event;

(b) where credit derivatives allow for cash settlement–

(i) institutions have in place a robust valuation process in order to estimate loss reliably;

(ii) there is a clearly specified period for obtaining post-credit-event valuations of the underlying obligation;

(c) where the protection purchaser's right and ability to transfer the underlying obligation to the protection provider is required for settlement, the terms of the underlying obligation provide that any required consent to such transfer must not be unreasonably withheld;

(d) the identity of the parties responsible for determining whether a credit event has occurred is clearly defined;

(e) the determination of the credit event is not the sole responsibility of the protection provider;

(f) the protection buyer has the right or ability to inform the protection provider of the occurrence of a credit event.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Where the credit events do not include restructuring of the underlying obligation as described in sub-paragraph (a)(iii), the credit protection may nonetheless be eligible subject to a reduction in the value as specified in Article 233(2);

(2) A mismatch between the underlying obligation and the reference obligation under the credit derivative or between the underlying obligation and the obligation used for purposes of determining whether a credit event has occurred is permissible only where both the following conditions are met–

(a) the reference obligation or the obligation used for the purpose of determining whether a credit event has occurred, as the case may be, ranks *pari passu* with or is junior to the underlying obligation;

(b) the underlying obligation and the reference obligation or the obligation used for the purpose of determining whether a credit event has occurred, as the case may be, share the same obligor and legally enforceable cross-default or cross-acceleration clauses are in place.

Requirements to qualify for the treatment set out in Article 153(3).

217.(1) To be eligible for the treatment set out in Article 153(3), credit protection deriving from a guarantee or credit derivative must meet the following conditions–

(a) the underlying obligation is to one of the following exposures–

(i) a corporate exposure as referred to in Article 147, excluding insurance and reinsurance undertakings;

(ii) an exposure to a regional government, local authority or public sector entity which is not treated as an exposure to a central government or a central bank in accordance with Article 147;

(iii) an exposure to an SME, classified as a retail exposure in accordance with Article 147(5);

(b) the underlying obligors are not members of the same group as the protection provider;

(c) the exposure is hedged by one of the following instruments–

(i) single-name unfunded credit derivatives or single-name guarantees;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(ii) first-to-default basket products;

(iii) nth-to-default basket products;

(d) the credit protection meets the requirements set out in Articles 213, 215 and 216, as applicable;

(e) the risk weight that is associated with the exposure prior to the application of the treatment set out in Article 153(3), does not already factor in any aspect of the credit protection;

(f) an institution has the right and expectation to receive payment from the protection provider without having to take legal action in order to pursue the counterparty for payment. To the extent possible, the institution must take steps to satisfy itself that the protection provider is willing to pay promptly should a credit event occur;

(g) the purchased credit protection absorbs all credit losses incurred on the hedged portion of an exposure that arise due to the occurrence of credit events outlined in the contract;

(h) where the payout structure of the credit protection provides for physical settlement, there is legal certainty with respect to the deliverability of a loan, bond, or contingent liability;

(i) where an institution intends to deliver an obligation other than the underlying exposure, it must ensure that the deliverable obligation is sufficiently liquid so that the institution would have the ability to purchase it for delivery in accordance with the contract;

(j) the terms and conditions of credit protection arrangements are legally confirmed in writing by both the protection provider and the institution;

(k) institutions have in place a process to detect excessive correlation between the creditworthiness of a protection provider and the obligor of the underlying exposure due to their performance being dependent on common factors beyond the systematic risk factor;

(l) in the case of protection against dilution risk, the seller of purchased receivables is not a member of the same group as the protection provider.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(2) For the purpose of paragraph (1)(c)(ii), institutions must apply the treatment set out in Article 153(3) to the asset within the basket with the lowest risk-weighted exposure amount.

(3) For the purpose of paragraph (1)(c)(iii), the protection obtained is only eligible for consideration under this framework where eligible (n-1)th default protection has also been obtained or where (n-1) of the assets within the basket has or have already defaulted. Where this is the case, institutions must apply the treatment set out in Article 153(3) to the asset within the basket with the lowest risk-weighted exposure amount.

Calculating the effects of credit risk mitigation

Credit linked notes.

218. Investments in credit linked notes issued by the lending institution may be treated as cash collateral for the purpose of calculating the effect of funded credit protection in accordance with this Articles and Articles 219 to 232, if the credit default swap embedded in the credit linked note qualifies as eligible unfunded credit protection. For the purpose of determining whether the credit default swap embedded in a credit linked note qualifies as eligible unfunded credit protection, the institution may consider the condition in Article 194(6)(c) to be met.

On-balance sheet netting.

219. Loans to and deposits with the lending institution subject to on-balance sheet netting are to be treated by that institution as cash collateral for the purpose of calculating the effect of funded credit protection for those loans and deposits of the lending institution subject to on-balance sheet netting which are denominated in the same currency.

Using the Supervisory Volatility Adjustments Approach or the Own Estimates Volatility Adjustments Approach for master netting agreements.

220.(1) When institutions calculate the 'fully adjusted exposure value' (E*) for the exposures subject to an eligible master netting agreement covering repurchase transactions or securities or commodities lending or borrowing transactions or other capital market-driven transactions, they must calculate the volatility adjustments that they need to apply either by using the Supervisory Volatility Adjustments Approach or the Own Estimates Volatility Adjustments Approach ("Own Estimates Approach") as set out in Articles 223 to 226 for the Financial Collateral Comprehensive Method.

The use of the Own Estimates Approach must be subject to the same conditions and requirements as apply under the Financial Collateral Comprehensive Method.

(2) For the purpose of calculating E*, institutions must–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) calculate the net position in each group of securities or in each type of commodity by subtracting the amount in paragraph (ii) from the amount in paragraph (i)–

(i) the total value of a group of securities or of commodities of the same type lent, sold or provided under the master netting agreement;

(ii) the total value of a group of securities or of commodities of the same type borrowed, purchased or received under the master netting agreement;

(b) calculate the net position in each currency, other than the settlement currency of the master netting agreement, by subtracting the amount in paragraph (ii) from the amount in paragraph (i)–

(i) the sum of the total value of securities denominated in that currency lent, sold or provided under the master netting agreement and the amount of cash in that currency lent or transferred under that agreement;

(ii) the sum of the total value of securities denominated in that currency borrowed, purchased or received under the master netting agreement and the amount of cash in that currency borrowed or received under that agreement;

(c) apply the volatility adjustment appropriate to a given group of securities or to a cash position to the absolute value of the positive or negative net position in the securities in that group;

(d) apply the foreign exchange risk (fx) volatility adjustment to the net positive or negative position in each currency other than the settlement currency of the master netting agreement.

(3) Institutions must calculate E* in accordance with the following formula–

$$E^* = \max\left\{0, \left(\sum_i E_i - \sum_i C_i\right) + \sum_j \left|E_{sec}^j\right| \times H_{sec}^j + \sum_k \left|E_{fx}^k\right| \times H_{fx}^k\right\}$$

where–

E_i = the exposure value for each separate exposure i under the agreement that would apply in the absence of the credit protection, where institutions calculate risk-weighted exposure amounts under the Standardised Approach or where they

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

calculate the risk-weighted exposure amounts and expected loss amounts under the IRB Approach;

C_i = the value of securities in each group or commodities of the same type borrowed, purchased or received or the cash borrowed or received in respect of each exposure i;

E^j_{sec} = the net position (positive or negative) in a given group of securities j;

E^k_{fx} = the net position (positive or negative) in a given currency k other than the settlement currency of the agreement as calculated under paragraph (2)(b);

H^j_{sec} = the volatility adjustment appropriate to a particular group of securities j;

H^k_{fx} = the foreign exchange volatility adjustment for currency k.

(4) For the purpose of calculating risk-weighted exposure amounts and expected loss amounts for repurchase transactions or securities or commodities lending or borrowing transactions or other capital market-driven transactions covered by master netting agreements, institutions must use E* as calculated under paragraph (3) as the exposure value of the exposure to the counterparty arising from the transactions subject to the master netting agreement for the purposes of Article 113 under the Standardised Approach or Chapter 3 under the IRB Approach.

(5) For the purposes of paragraphs (2) and (3), “group of securities” means securities which are issued by the same entity, have the same issue date, the same maturity, are subject to the same terms and conditions, and are subject to the same liquidation periods as indicated in Articles 224 and 225, as applicable.

Using the internal models approach for master netting agreements.

221.(1) Subject to GFSC approval, institutions may, as an alternative to using the Supervisory Volatility Adjustments Approach or the Own Estimates Approach in calculating the fully adjusted exposure value (E*) resulting from the application of an eligible master netting agreement covering repurchase transactions, securities or commodities lending or borrowing transactions, or other capital market driven transactions other than derivative transactions, use an internal models approach which takes into account correlation effects between security positions subject to the master netting agreement as well as the liquidity of the instruments concerned.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(2) Subject to GFSC approval, institutions may also use their internal models for margin lending transactions, where the transactions are covered under a bilateral master netting agreement that meets the requirements set out in Articles 295 to 298.

(3) An institution may choose to use an internal models approach independently of the choice it has made between the Standardised Approach and the IRB Approach for the calculation of risk-weighted exposure amounts. However, where an institution seeks to use an internal models approach, it must do so for all counterparties and securities, excluding immaterial portfolios where it may use the Supervisory Volatility Adjustments Approach or the Own Estimates Approach as laid down in Article 220.

Institutions that have received approval for an internal risk-measurement model under Title 4, Chapter 5 may use the internal models approach. Where an institution has not received such approval, it may still apply for approval from the GFSC to use an internal models approach for the purposes of this Article.

(4) The GFSC must permit an institution to use an internal models approach only where they are satisfied that the institution's system for managing the risks arising from the transactions covered by the master netting agreement is conceptually sound and implemented with integrity and where the following qualitative standards are met–

(a) the internal risk-measurement model used for calculating the potential price volatility for the transactions is closely integrated into the daily risk-management process of the institution and serves as the basis for reporting risk exposures to the senior management of the institution;

(b) the institution has a risk control unit that meets all the following requirements–

(i) it is independent from business trading units and reports directly to senior management;

(ii) it is responsible for designing and implementing the institution's risk-management system;

(iii) it produces and analyses daily reports on the output of the risk-measurement model and on the appropriate measures to be taken in terms of position limits;

(c) the daily reports produced by the risk-control unit are reviewed by a level of management with sufficient authority to enforce reductions of positions taken and of overall risk exposure;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(d) the institution has sufficient staff skilled in the use of sophisticated models in the risk control unit;

(e) the institution has established procedures for monitoring and ensuring compliance with a documented set of internal policies and controls concerning the overall operation of the risk-measurement system;

(f) the institution's models have a proven track record of reasonable accuracy in measuring risks demonstrated through the back-testing of its output using at least one year of data;

(g) the institution frequently conducts a rigorous programme of stress testing and the results of these tests are reviewed by senior management and reflected in the policies and limits it sets;

(h) the institution conducts, as part of its regular internal auditing process, an independent review of its risk-measurement system. This review must include both the activities of the business trading units and of the independent risk-control unit;

(i) at least once a year, the institution conducts a review of its risk-management system;

(j) the internal model meets the requirements set out in Article 292(8) and (9) and in Article 294.

(5) An institution's internal risk-measurement model must capture a sufficient number of risk factors in order to capture all material price risks.

An institution may use empirical correlations within risk categories and across risk categories where its system for measuring correlations is sound and implemented with integrity.

(6) Institutions using the internal models approach must calculate E* in accordance with the following formula–

$$E^* = \max\{0, (\sum_i E_i - \sum_i C_i) + \text{potential change in value}\}$$

where–

E i = the exposure value for each separate exposure i under the agreement that would apply in the absence of the credit protection, where institutions calculate the

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

risk-weighted exposure amounts under the Standardised Approach or where they calculate risk-weighted exposure amounts and expected loss amounts under the IRB Approach;

C_i = the value of the securities borrowed, purchased or received or the cash borrowed or received in respect of each such exposure i.

When calculating risk-weighted exposure amounts using internal models, institutions must use the previous business day's model output.

(7) The calculation of the potential change in value referred to in paragraph (6) must be subject to all the following standards–

(a) it is carried out at least daily;

(b) it is based on a 99th percentile, one-tailed confidence interval;

(c) it is based on a 5-day equivalent liquidation period, except in the case of transactions other than securities repurchase transactions or securities lending or borrowing transactions where a 10-day equivalent liquidation period must be used;

(d) it is based on an effective historical observation period of at least one year except where a shorter observation period is justified by a significant upsurge in price volatility;

(e) the data set used in the calculation is updated every three months.

Where an institution has a repurchase transaction, a securities or commodities lending or borrowing transaction and margin lending or similar transaction or netting set which meets the criteria set out in Article 285(2), (3) and (4), the minimum holding period must be brought in line with the margin period of risk that would apply under those paragraphs, in combination with Article 285(5).

(8) For the purpose of calculating risk-weighted exposure amounts and expected loss amounts for repurchase transactions or securities or commodities lending or borrowing transactions or other capital market-driven transactions covered by master netting agreements, institutions must use E* as calculated under paragraph (6) as the exposure value of the exposure to the counterparty arising from the transactions subject to the master netting agreement for the purposes of Article 113 under the Standardised Approach or Chapter 3 under the IRB Approach.

(9) [Not used]

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Financial Collateral Simple Method.

222.(1) Institutions may use the Financial Collateral Simple Method only where they calculate risk-weighted exposure amounts under the Standardised Approach. Institution must not use both the Financial Collateral Simple Method and the Financial Collateral Comprehensive Method, except for the purposes of Articles 148(1) and 150(1). Institutions must not use this exception selectively with the purpose of achieving reduced own funds requirements or with the purpose of conducting regulatory arbitrage.

(2) Under the Financial Collateral Simple Method institutions must assign to eligible financial collateral a value equal to its market value as determined in accordance with f Article 207(4)(d).

(3) Institutions must assign to those portions of exposure values that are collateralised by the market value of eligible collateral the risk weight that they would assign under Chapter 2 where the lending institution had a direct exposure to the collateral instrument. For this purpose, the exposure value of an off-balance sheet item listed in Schedule 1 must be equal to 100% of the item's value rather than the exposure value indicated in Article 111(1).

The risk weight of the collateralised portion must be at least 20% except as specified in paragraphs (4) to (6). Institutions must apply to the remainder of the exposure value the risk weight that they would assign to an unsecured exposure to the counterparty under Chapter 2.

(4) Institutions must assign a risk weight of 0% to the collateralised portion of the exposure arising from repurchase transaction and securities lending or borrowing transactions which fulfil the criteria in Article 227. Where the counterparty to the transaction is not a core market participant, institutions must assign a risk weight of 10%.

(5) Institutions must assign a risk weight of 0%, to the extent of the collateralisation, to the exposure values determined under Chapter 6 for the derivative instruments listed in Schedule 2 and subject to daily marking-to-market, collateralised by cash or cash assimilated instruments where there is no currency mismatch.

Institutions must assign a risk weight of 10%, to the extent of the collateralisation, to the exposure values of such transactions collateralised by debt securities issued by central governments or central banks which are assigned a 0% risk weight under Chapter 2.

(6) For transactions other than those referred to in paragraphs (4) and (5), institutions may assign a 0% risk weight where the exposure and the collateral are denominated in the same currency, and either of the following conditions is met–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) the collateral is cash on deposit or a cash assimilated instrument;

(b) the collateral is in the form of debt securities issued by central governments or central banks eligible for a 0% risk weight under Article 114, and its market value has been discounted by 20%.

(7) For the purpose of paragraphs (5) and (6) debt securities issued by central governments or central banks must include–

(a) debt securities issued by regional governments or local authorities exposures to which are treated as exposures to the central government in whose jurisdiction they are established under Article 115;

(b) debt securities issued by multilateral development banks to which a 0% risk weight is assigned under or by virtue of Article 117(2);

(c) debt securities issued by international organisations which are assigned a 0% risk weight under Article 118;

(d) debt securities issued by public sector entities which are treated as exposures to central governments in accordance with Article 116(4).

Financial Collateral Comprehensive Method.

223.(1) In order to take account of price volatility, institutions must apply volatility adjustments to the market value of collateral, as set out in Articles 224 to 227, when valuing financial collateral for the purposes of the Financial Collateral Comprehensive Method.

Where collateral is denominated in a currency that differs from the currency in which the underlying exposure is denominated, institutions must add an adjustment reflecting currency volatility to the volatility adjustment appropriate to the collateral as set out in Articles 224 to 227.

In the case of OTC derivatives transactions covered by netting agreements recognised by the GFSC under Chapter 6, institutions must apply a volatility adjustment reflecting currency volatility when there is a mismatch between the collateral currency and the settlement currency. Even where multiple currencies are involved in the transactions covered by the netting agreement, institutions must apply a single volatility adjustment.

(2) Institutions must calculate the volatility-adjusted value of the collateral (C VA) they need to take into account as follows–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

$$C_{VA} = C \cdot (1 - H_C - H_{fx})$$

where–

C = the value of the collateral;

H C = the volatility adjustment appropriate to the collateral, as calculated under Articles 224 and 227;

H fx = the volatility adjustment appropriate to currency mismatch, as calculated under Articles 224 and 227.

Institutions must use the formula in this paragraph when calculating the volatility-adjusted value of the collateral for all transactions except for those transactions subject to recognised master netting agreements to which the provisions set out in Articles 220 and 221 apply.

(3) Institutions must calculate the volatility-adjusted value of the exposure (E VA) they need to take into account as follows–

$$E_{VA} = E \cdot (1 + H_E)$$

where–

E = the exposure value as would be determined under Chapter 2 or Chapter 3, as applicable, where the exposure was not collateralised;

H E = the volatility adjustment appropriate to the exposure, as calculated under Articles 224 and 227.

In the case of OTC derivative transactions, institutions using the method laid down in Articles 283 to 294 must calculate EVA as follows–

$$E_{VA} = E$$

(4) For the purpose of calculating E in paragraph (3), the following must apply–

(a) for institutions calculating risk-weighted exposure amounts under the Standardised Approach, the exposure value of an off-balance sheet item listed in Schedule 1 must be 100% of that item's value rather than the exposure value indicated in Article 111(1);

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(b) for institutions calculating risk-weighted exposure amounts under the IRB Approach, they must calculate the exposure value of the items listed in Article 166(8) to (10) by using a conversion factor of 100% rather than the conversion factors or percentages indicated in those paragraphs.

(5) Institutions must calculate the fully adjusted value of the exposure (E*), taking into account both volatility and the risk-mitigating effects of collateral as follows–

$$E^{*} = \max\{0, E_{VA} - C_{VAM}\}$$

where–

E VA = the volatility adjusted value of the exposure as calculated in paragraph (3);

C VAM = C VA further adjusted for any maturity mismatch in accordance with Articles 237 to 239;

In the case of OTC derivative transactions, institutions using the methods laid down in Articles 274 to 282 must take into account the risk-mitigating effects of collateral in accordance with the provisions laid down in Articles 274 to 282, as applicable.

(6) Institutions may calculate volatility adjustments either by using the Supervisory Volatility Adjustments Approach referred to in Article 224 or the Own Estimates Approach referred to in Article 225.

An institution may choose to use the Supervisory Volatility Adjustments Approach or the Own Estimates Approach independently of the choice it has made between the Standardised Approach and the IRB Approach for the calculation of risk-weighted exposure amounts.

However, where an institution uses the Own Estimates Approach, it must do so for the full range of instrument types, excluding immaterial portfolios where it may use the Supervisory Volatility Adjustments Approach.

(7) Where the collateral consists of a number of eligible items, institutions must calculate the volatility adjustment (H) as follows–

$$H = \sum_{i} a_i H_i$$

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

where–

a_i = the proportion of the value of an eligible item i in the total value of collateral;

H_i = the volatility adjustment applicable to eligible item i.

Supervisory volatility adjustment under the Financial Collateral Comprehensive Method

224.(1) The volatility adjustments to be applied by institutions under the Supervisory Volatility Adjustments Approach, assuming daily revaluation, must be those set out in Tables 1 to 4 of this paragraph.

VOLATILITY ADJUSTMENTS

Table 1										
Credit quality step with which the credit assessment of the debt security is associated	Residual Maturity	Volatility adjustments for debt securities issued by entities described in Article 197(1)(b)			Volatility adjustments for debt securities issued by entities described in Article 197(1) (c) and (d)			Volatility adjustments for securitisation positions and meeting the criteria in Article 197(1) (h)		
		20-day liquidation period (%)	10-day liquidation period (%)	5-day liquidation period (%)	20-day liquidation period (%)	10-day liquidation period (%)	5-day liquidation period (%)	20-day liquidation period (%)	10-day liquidation period (%)	5-day liquidation period (%)
1	≤ 1 year	0,707	0,5	0,354	1,414	1	0,707	2,829	2	1,414
	>1 ≤ 5 years	2,828	2	1,414	5,657	4	2,828	11,314	8	5,657
	> 5 years	5,657	4	2,828	11,314	8	5,657	22,628	16	11,313
2-3	≤ 1 year	1,414	1	0,707	2,828	2	1,414	5,657	4	2,828
	>1 ≤ 5 years	4,243	3	2,121	8,485	6	4,243	16,971	12	8,485
	> 5 years	8,485	6	4,243	16,971	12	8,485	33,942	24	16,970
4	≤ 1 year	21,213	15	10,607	N/A	N/A	N/A	N/A	N/A	N/A
	>1 ≤ 5 years	21,213	15	10,607	N/A	N/A	N/A	N/A	N/A	N/A
	> 5 years	21,213	15	10,607	N/A	N/A	N/A	N/A	N/A	N/A

Table 2									
Credit quality step with which the credit assessment of a short term debt security is associated	Volatility adjustments for debt securities issued by entities described in Article 197(1) (b) with short-term credit assessments			Volatility adjustments for debt securities issued by entities described in Article 197(1) (c) and (d) with short-term credit assessments			Volatility adjustments for securitisation positions and meeting the criteria in Article 197(1)(h)		
	20-day liquidation period (%)	10-day liquidation period (%)	5-day liquidation period (%)	20-day liquidation period (%)	10-day liquidation period (%)	5-day liquidation period (%)	20-day liquidation period (%)	10-day liquidation period (%)	5-day liquidation period (%)
1	0,707	0,5	0,354	1,414	1	0,707	2,829	2	1,414
2-3	1,414	1	0,707	2,828	2	1,414	5,657	4	2,828

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Table 3			
Other collateral or exposure types			
	20-day liquidation period (%)	10-day liquidation period (%)	5-day liquidation period (%)
Main Index Equities, Main Index Convertible Bonds	21,213	15	10,607
Other Equities or Convertible Bonds listed on a recognised exchange	35,355	25	17,678
Cash	0	0	0
Gold	21,213	15	10,607

Table 4		
Volatility adjustment for currency mismatch		
20-day liquidation period (%)	10-day liquidation period (%)	5-day liquidation period %)
11,314	8	5,657

(2) The calculation of volatility adjustments in accordance with paragraph (1) must be subject to the following conditions–

(a) for secured lending transactions the liquidation period must be 20 business days;

(b) for repurchase transactions, except so far as such transactions involve the transfer of commodities or guaranteed rights relating to title to commodities, and securities lending or borrowing transactions the liquidation period must be 5 business days;

(c) for other capital market driven transactions, the liquidation period must be 10 business days.

Where an institution has a transaction or netting set which meets the criteria set out in Article 285(2), (3) and (4), the minimum holding period must be brought in line with the margin period of risk that would apply under those paragraphs.

(3) In Tables 1 to 4 of paragraph (1) and in paragraphs (4) to (6), the credit quality step with which a credit assessment of the debt security is associated is the credit quality step with which the credit assessment is determined by the GFSC to be associated under Chapter 2.

For the purpose of determining the credit quality step with which a credit assessment of the debt security is associated referred to in the first sub-paragraph, Article 197(7) also applies.

(4) For non-eligible securities or for commodities lent or sold under repurchase transactions or securities or commodities lending or borrowing transactions, the volatility adjustment is the same as for non-main index equities listed on a recognised exchange.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(5) For eligible units in CIUs the volatility adjustment is the weighted average volatility adjustments that would apply, having regard to the liquidation period of the transaction as specified in paragraph (2), to the assets in which the fund has invested.

Where the assets in which the fund has invested are not known to the institution, the volatility adjustment is the highest volatility adjustment that would apply to any of the assets in which the fund has the right to invest.

(6) For unrated debt securities issued by institutions or investment firms and satisfying the eligibility criteria in Article 197(4), the volatility adjustments is the same as for securities issued by institutions or corporates with an external credit assessment associated with credit quality step 2 or 3.

Own estimates of volatility adjustments under the Financial Collateral Comprehensive Method.

225.(1) The GFSC may permit institutions to use their own volatility estimates for calculating the volatility adjustments to be applied to collateral and exposures where those institutions comply with the requirements set out in paragraphs (2) and (3). Institutions which have obtained approval to use their own volatility estimates must not revert to the use of other methods except for demonstrated good cause and subject to GFSC approval.

For debt securities that have a credit assessment from an ECAI equivalent to investment grade or better, institutions may calculate a volatility estimate for each category of security.

For debt securities that have a credit assessment from an ECAI equivalent to below investment grade, and for other eligible collateral, institutions must calculate the volatility adjustments for each individual item.

Institutions using the Own Estimates Approach must estimate volatility of the collateral or foreign exchange mismatch without taking into account any correlations between the unsecured exposure, collateral or exchange rates.

In determining relevant categories, institutions must take into account the type of issuer of the security, the external credit assessment of the securities, their residual maturity, and their modified duration. Volatility estimates must be representative of the securities included in the category by the institution.

(2) The calculation of the volatility adjustments must be subject to all the following criteria–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) institutions must base the calculation on a 99th percentile, one-tailed confidence interval;

(b) institutions must base the calculation on the following liquidation periods–

(i) 20 business days for secured lending transactions;

(ii) 5 business days for repurchase transactions, except so far as such transactions involve the transfer of commodities or guaranteed rights relating to title to commodities and securities lending or borrowing transactions;

(iii) 10 business days for other capital market driven transactions;

(c) institutions may use volatility adjustment numbers calculated in accordance with shorter or longer liquidation periods, scaled up or down to the liquidation period set out in sub-paragraph (b) for the type of transaction in question, using the square root of time formula–

$$H_M = H_N \times \sqrt{\frac{T_M}{T_N}}$$

where–

T M = the relevant liquidation period;

H M = the volatility adjustment based on the liquidation period T M;

H N = the volatility adjustment based on the liquidation period T N.

(d) institutions must take into account the illiquidity of lower-quality assets. They must adjust the liquidation period upwards in cases where there is doubt concerning the liquidity of the collateral. They must also identify where historical data may understate potential volatility. Such cases must be dealt with by means of a stress scenario;

(e) the length of the historical observation period institutions use for calculating volatility adjustments must be at least one year. For institutions that use a weighting scheme or other methods for the historical observation period, the length of the effective observation period must be at least one year. The GFSC may also

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

require an institution to calculate its volatility adjustments using a shorter observation period where, in the GFSC's judgement, this is justified by a significant upsurge in price volatility;

(f) institutions must update their data sets and calculate volatility adjustments at least once every three months. They must also reassess their data sets whenever market prices are subject to material changes.

(3) The estimation of volatility adjustments must meet all the following qualitative criteria–

(a) institutions must use the volatility estimates in the day-to-day risk management process including in relation to its internal exposure limits;

(b) where the liquidation period used by an institution in its day-to-day risk management process is longer than that set out in Articles 218 to 236 for the type of transaction in question, that institution must scale up its volatility adjustments in accordance with the square root of time formula set out in paragraph (2)(c);

(c) an institution must have in place established procedures for monitoring and ensuring compliance with a documented set of policies and controls for the operation of its system for the estimation of volatility adjustments and for the integration of such estimations into its risk management process;

(d) an independent review of the institution's system for the estimation of volatility adjustments must be carried out regularly within the institution's own internal auditing process. A review of the overall system for the estimation of volatility adjustments and for the integration of those adjustments into the institution's risk management process must take place at least once a year. The subject of that review must include at least the following–

(i) the integration of estimated volatility adjustments into daily risk management;

(ii) the validation of any significant change in the process for the estimation of volatility adjustments;

(iii) the verification of the consistency, timeliness and reliability of data sources used to run the system for the estimation of volatility adjustments, including the independence of such data sources;

(iv) the accuracy and appropriateness of the volatility assumptions.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Scaling up of volatility adjustment under the Financial Collateral Comprehensive Method.

226. The volatility adjustments set out in Article 224 are the volatility adjustments an institution must apply where there is daily revaluation. Similarly, where an institution uses its own estimates of the volatility adjustments in accordance with Article 225, it must calculate them in the first instance on the basis of daily revaluation. Where the frequency of revaluation is less than daily, institutions must apply larger volatility adjustments. Institutions must calculate them by scaling up the daily revaluation volatility adjustments, using the following square-root-of-time formula–

$$H = H_M \times \sqrt{\frac{N_R + (T_M - 1)}{T_M}}$$

where–

H = the volatility adjustment to be applied;

H M = the volatility adjustment where there is daily revaluation;

N R = the actual number of business days between revaluations;

T M = the liquidation period for the type of transaction in question.

Conditions for applying a 0% volatility adjustment under the Financial Collateral Comprehensive Method.

227.(1) In relation to repurchase transactions and securities lending or borrowing transactions, where an institution uses the Supervisory Volatility Adjustments Approach under Article 224 or the Own Estimates Approach under Article 225 and where the conditions set out in paragraph (2)(a) to (h) are satisfied, institutions may, instead of applying the volatility adjustments calculated under Articles 224 to 226, apply a 0% volatility adjustment. Institutions using the internal models approach set out in Article 221 must not use the treatment set out in this Article.

(2) Institutions may apply a 0% volatility adjustment where all the following conditions are met–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) both the exposure and the collateral are cash or debt securities issued by central governments or central banks within the meaning of Article 197(1)(b) and eligible for a 0% risk weight under Chapter 2;

(b) both the exposure and the collateral are denominated in the same currency;

(c) either the maturity of the transaction is no more than one day or both the exposure and the collateral are subject to daily marking-to-market or daily re-margining;

(d) the time between the last marking-to-market before a failure to re-margin by the counterparty and the liquidation of the collateral is no more than four business days;

(e) the transaction is settled in a settlement system proven for that type of transaction;

(f) the documentation covering the agreement or transaction is standard market documentation for repurchase transactions or securities lending or borrowing transactions in the securities concerned;

(g) the transaction is governed by documentation specifying that where the counterparty fails to satisfy an obligation to deliver cash or securities or to deliver margin or otherwise defaults, then the transaction is immediately terminable;

(h) the counterparty is considered a core market participant by the GFSC.

(3) The core market participants referred to in paragraph (2)(h) must include the following entities–

(a) the entities mentioned in Article 197(1)(b) exposures to which are assigned a 0% risk weight under Chapter 2;

(b) institutions;

(ba) investment firms;

(c) other financial undertakings that are an insurance or reinsurance undertaking, an insurance holding company, or a mixed financial holding company exposures to which are assigned a 20% risk weight under the Standardised Approach or which, in the case of institutions calculating risk-weighted exposure amounts and expected loss amounts under the IRB Approach, do not have a credit assessment by a recognised ECAI and are internally rated by the institution;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(d) regulated CIUs that are subject to capital or leverage requirements;

(e) regulated pension funds;

(f) recognised clearing organisations.

Calculating risk-weighted exposure amounts and expected loss amounts under the Financial Collateral Comprehensive method.

228.(1) Under the Standardised Approach, institutions must use E* as calculated under Article 223(5) as the exposure value for the purposes of Article 113. In the case of off-balance sheet items listed in Schedule 1, institutions must use E* as the value to which the percentages indicated in Article 111(1) must be applied to arrive at the exposure value.

(2) Under the IRB Approach, institutions must use the effective LGD (LGD*) as the LGD for the purposes of Chapter 3. Institutions must calculate LGD* as follows–

$$LGD^* = LGD \times \frac{E^*}{E}$$

where–

LGD = the LGD that would apply to the exposure under Chapter 3 where the exposure was not collateralised;

E = the exposure value in accordance with Article 223(3);

E* = the fully adjusted exposure value in accordance with Article 223(5).

Valuation principles for other eligible collateral under the IRB Approach.

229.(1) For immovable property collateral, the collateral must be valued by an independent valuer at or at less than the market value. An institution must require the independent valuer to document the market value in a transparent and clear manner.

If rigorous criteria are in force at the time in Gibraltar for the assessment of the mortgage lending value the immovable property may instead be valued by an independent valuer at or at less than the mortgage lending value. Institutions must require the independent valuer not to take into account speculative elements in the assessment of the mortgage lending value and to document that value in a transparent and clear manner.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

The value of the collateral must be the market value or mortgage lending value reduced as appropriate to reflect the results of the monitoring required under Article 208(3) and to take account of any prior claims on the immovable property.

(2) For receivables, the value of receivables must be the amount receivable.

(3) Institutions must value physical collateral other than immovable property at its market value. For the purposes of this Article, the market value is the estimated amount for which the property would exchange on the date of valuation between a willing buyer and a willing seller in an arm's-length transaction.

Calculating risk-weighted exposure amounts and expected loss amounts for other eligible collateral under the IRB Approach.

230.(1) Institutions must use LGD* calculated in accordance with this paragraph and paragraph (2) as the LGD for the purposes of Chapter 3.

Where the ratio of the value of the collateral (C) to the exposure value (E) is below the required minimum collateralisation level of the exposure (C*) as laid down in Table 5, LGD* must be the LGD laid down in Chapter 3 for uncollateralised exposures to the counterparty. For this purpose, institutions must calculate the exposure value of the items listed in Article 166(8) to (10) by using a conversion factor or percentage of 100% rather than the conversion factors or percentages indicated in those paragraphs.

Where the ratio of the value of the collateral to the exposure value exceeds a second, higher threshold level of C** as laid down in Table 5, LGD* must be that prescribed in Table 5.

Where the required level of collateralisation C** is not achieved in respect of the exposure as a whole, institutions must consider the exposure to be two exposures — one corresponding to the part in respect of which the required level of collateralisation C** is achieved and one corresponding to the remainder.

(2) The applicable LGD* and required collateralisation levels for the secured parts of exposures are set out in Table 5 of this paragraph.

Table 5

Minimum LGD for secured parts of exposures

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

	LGD* for senior exposure	LGD* for subordinated exposures	Required minimum collateralisation level of the exposure (C*)	Required minimum collateralisation level of the exposure (C**)
Receivables	35 %	65 %	0 %	125 %
Residential property/commercial immovable property	35 %	65 %	30 %	140 %
Other collateral	40 %	70 %	30 %	140 %

(3) As an alternative to the treatment set out in paragraphs (1) and (2), and subject to Article 124(2), institutions may assign a 50% risk weight to the part of the exposure that is, within the limits set out in Article 125(2)(d) and Article 126(2)(d) respectively, fully collateralised by residential property or commercial immovable property in Gibraltar where all the conditions in Article 199(3) or (4) are met.

Calculating risk-weighted exposure amounts and expected loss amounts in the case of mixed pools of collateral.

231.(1) An institution must calculate the value of LGD* that it must use as the LGD for the purposes of Chapter 3 in accordance with paragraphs (2) and (3) where both the following conditions are met–

(a) the institution uses the IRB Approach to calculate risk-weighted exposure amounts and expected loss amounts;

(b) an exposure is collateralised by both financial collateral and other eligible collateral.

(2) Institutions must be required to subdivide the volatility-adjusted value of the exposure, obtained by applying the volatility adjustment as set out in Article 223(5) to the value of the exposure, into parts so as to obtain a part covered by eligible financial collateral, a part covered by receivables, a part covered by commercial immovable property collateral or residential property collateral, a part covered by other eligible collateral, and the unsecured part, as applicable.

(3) Institutions must calculate LGD* for each part of the exposure obtained in paragraph (2) separately in accordance with the relevant provisions of this Chapter.

Other funded credit protection.

232.(1) Where the conditions set out in Article 212(1) are met, a deposit with a third party institution may be treated as a guarantee by the third party institution.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(2) Where the conditions set out in Article 212(2) are met, institutions must subject the portion of the exposure collateralised by the current surrender value of life insurance policies pledged to the lending institution to the following treatment–

(a) where the exposure is subject to the Standardised Approach, it must be risk-weighted by using the risk weights specified in paragraph (3);

(b) where the exposure is subject to the IRB Approach but not subject to the institution's own estimates of LGD, it is assigned an LGD of 40%.

In the event of a currency mismatch, institutions must reduce the current surrender value in accordance with Article 233(3), the value of the credit protection being the current surrender value of the life insurance policy.

(3) For the purposes of paragraph (2)(a), institutions must assign the following risk weights on the basis of the risk weight assigned to a senior unsecured exposure to the undertaking providing the life insurance–

(a) a risk weight of 20%, where the senior unsecured exposure to the undertaking providing the life insurance is assigned a risk weight of 20%;

(b) a risk weight of 35%, where the senior unsecured exposure to the undertaking providing the life insurance is assigned a risk weight of 50%;

(c) a risk weight of 70%, where the senior unsecured exposure to the undertaking providing the life insurance is assigned a risk weight of 100%;

(d) a risk weight of 150%, where the senior unsecured exposure to the undertaking providing the life insurance is assigned a risk weight of 150%.

(4) Institutions may treat instruments repurchased on request that are eligible under Article 200(c) as a guarantee by the issuing institution. The value of the eligible credit protection must be the following–

(a) where the instrument will be repurchased at its face value, the value of the protection must be that amount;

(b) where the instrument will be repurchased at market price, the value of the protection must be the value of the instrument valued in the same way as the debt securities that meet the conditions in Article 197(4).

Valuation.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

233.(1) For the purpose of calculating the effects of unfunded credit protection in accordance with this Article and Articles 234 to 236, the value of unfunded credit protection (G) must be the amount that the protection provider has undertaken to pay in the event of the default or non-payment of the borrower or on the occurrence of other specified credit events.

(2) In the case of credit derivatives which do not include as a credit event restructuring of the underlying obligation involving forgiveness or postponement of principal, interest or fees that result in a credit loss event the following applies–

(a) where the amount that the protection provider has undertaken to pay is not higher than the exposure value, institutions must reduce the value of the credit protection calculated under paragraph (1) by 40%;

(b) where the amount that the protection provider has undertaken to pay is higher than the exposure value, the value of the credit protection must be no higher than 60% of the exposure value.

(3) Where unfunded credit protection is denominated in a currency different from that in which the exposure is denominated, institutions must reduce the value of the credit protection by the application of a volatility adjustment as follows–

$$G^* = G \times (1 - H_{fx})$$

where–

G* = the amount of credit protection adjusted for foreign exchange risk,

G = the nominal amount of the credit protection;

H fx = the volatility adjustment for any currency mismatch between the credit protection and the underlying obligation determined in accordance with paragraph (4).

Where there is no currency mismatch H fx is equal to zero.

(4) Institutions must base the volatility adjustments for any currency mismatch on a 10 business day liquidation period, assuming daily revaluation, and may calculate them based on the Supervisory Volatility Adjustments Approach or the Own Estimates Approach as set out in Articles 224 and 225 respectively. Institutions must scale up the volatility adjustments in accordance with Article 226.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Calculating risk-weighted exposure amounts and expected loss amounts in the event of partial protection and tranching.

234. Where an institution transfers a part of the risk of a loan in one or more tranches, the rules set out in Chapter 5 apply. Institutions may consider materiality thresholds on payments below which no payment must be made in the event of loss to be equivalent to retained first loss positions and to give rise to a tranched transfer of risk.

Calculating risk-weighted exposure amounts under the Standardised Approach.

235.(1) For the purposes of Article 113(3) institutions must calculate the risk-weighted exposure amounts in accordance with the following formula–

$$\max\{0, E - G_A\} \times r + G_A \times g$$

where–

E = the exposure value in accordance with Article 111; for this purpose, the exposure value of an off-balance sheet item listed in Schedule 1 must be 100% of its value rather than the exposure value indicated in Article 111(1);

G A = the amount of credit risk protection as calculated under Article 233(3) (G*) further adjusted for any maturity mismatch as laid down in Articles 237 to 239;

r = the risk weight of exposures to the obligor as specified under Chapter 2;

g = the risk weight of exposures to the protection provider as specified under Chapter 2.

(2) Where the protected amount (G A) is less than the exposure (E), institutions may apply the formula specified in paragraph (1) only where the protected and unprotected parts of the exposure are of equal seniority.

(3) Institutions may extend the treatment set out in Article 114(4) and (7) to exposures or parts of exposures guaranteed by the central government or central bank, where the guarantee is denominated in the domestic currency of the borrower and the exposure is funded in that currency.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Calculating risk-weighted exposure amounts and expected loss amounts under the IRB Approach.

236.(1) For the covered portion of the exposure value (E), based on the adjusted value of the credit protection G A , the PD for the purposes of Articles 160 to 165 may be the PD of the protection provider, or a PD between that of the borrower and that of the guarantor where a full substitution is deemed not to be warranted. In the case of subordinated exposures and non-subordinated unfunded protection, the LGD to be applied by institutions for the purposes of Articles 160 to 165 may be that associated with senior claims.

(2) For any uncovered portion of the exposure value (E) the PD must be that of the borrower and the LGD must be that of the underlying exposure.

(3) For the purposes of this Article, G A is the value of G* as calculated under Article 233(3) further adjusted for any maturity mismatch as laid down in Articles 237 to 239. E is the exposure value determined in accordance with Articles 166 to 168. For this purpose, institutions must calculate the exposure value of the items listed in Article 166(8) to (10) by using a conversion factor or percentage of 100% rather than the conversion factors or percentages indicated in those paragraphs.

Maturity mismatches

Maturity mismatch.

237.(1) For the purpose of calculating risk-weighted exposure amounts, a maturity mismatch occurs when the residual maturity of the credit protection is less than that of the protected exposure. Where protection has a residual maturity of less than three months and the maturity of the protection is less than the maturity of the underlying exposure that protection does not qualify as eligible credit protection.

(2) Where there is a maturity mismatch the credit protection must not qualify as eligible where either of the following conditions is met–

(a) the original maturity of the protection is less than one year;

(b) the exposure is a short term exposure specified by the GFSC as being subject to a one-day floor rather than a one-year floor in respect of the maturity value (M) under Article 162(3).

Maturity of credit protection.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

238.(1) Subject to a maximum of five years, the effective maturity of the underlying must be the longest possible remaining time before the obligor is scheduled to fulfil its obligations. Subject to paragraph (2), the maturity of the credit protection must be the time to the earliest date at which the protection may terminate or be terminated.

(2) Where there is an option to terminate the protection which is at the discretion of the protection seller, institutions must take the maturity of the protection to be the time to the earliest date at which that option may be exercised. Where there is an option to terminate the protection which is at the discretion of the protection buyer and the terms of the arrangement at origination of the protection contain a positive incentive for the institution to call the transaction before contractual maturity, an institution must take the maturity of the protection to be the time to the earliest date at which that option may be exercised; otherwise the institution may consider that such an option does not affect the maturity of the protection.

(3) Where a credit derivative is not prevented from terminating prior to expiration of any grace period required for a default on the underlying obligation to occur as a result of a failure to pay institutions must reduce the maturity of the protection by the length of the grace period.

Valuation of protection.

239.(1) For transactions subject to funded credit protection under the Financial Collateral Simple Method, where there is a mismatch between the maturity of the exposure and the maturity of the protection, the collateral does not qualify as eligible funded credit protection.

(2) For transactions subject to funded credit protection under the Financial Collateral Comprehensive Method, institutions must reflect the maturity of the credit protection and of the exposure in the adjusted value of the collateral in accordance with the following formula–

$$C_{VAM} = C_{VA} \times \frac{t - t^*}{T - t^*}$$

where–

C VA = the volatility adjusted value of the collateral as specified in Article 223(2) or the amount of the exposure, whichever is lower;

t = the number of years remaining to the maturity date of the credit protection calculated in accordance with Article 238, or the value of T, whichever is lower;

T = the number of years remaining to the maturity date of the exposure calculated in accordance with Article 238, or five years, whichever is lower;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

$t^* = 0{,}25$.

Institutions must use C VAM as C VA further adjusted for maturity mismatch in the formula for the calculation of the fully adjusted value of the exposure (E*) set out in Article 223(5).

(3) For transactions subject to unfunded credit protection, institutions must reflect the maturity of the credit protection and of the exposure in the adjusted value of the credit protection in accordance with the following formula–

$$G_A = G^* \times \frac{t-t^*}{T-t^*}$$

where–

G A = G* adjusted for any maturity mismatch;

G* = the amount of the protection adjusted for any currency mismatch;

t = is the number of years remaining to the maturity date of the credit protection calculated in accordance with Article 238, or the value of T, whichever is lower;

T = is the number of years remaining to the maturity date of the exposure calculated in accordance with Article 238, or five years, whichever is lower;

$t^* = 0{,}25$.

Institutions must use G A as the value of the protection for the purposes of Articles 233 to 236.

Basket CRM techniques

First-to-default credit derivatives.

240. Where an institution obtains credit protection for a number of exposures under terms that the first default among the exposures must trigger payment and that this credit event will terminate the contract, the institution may amend the calculation of the risk-weighted exposure amount and, as relevant, the expected loss amount of the exposure which would, in the absence

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

of the credit protection, produce the lowest risk-weighted exposure amount in accordance with this Chapter–

(a) for institutions using the Standardised Approach, the risk-weighted exposure amount must be that calculated under the Standardised Approach;

(b) for institutions using the IRB Approach, the risk-weighted exposure amount must be the sum of the risk-weighted exposure amount calculated under the IRB Approach and 12.5 times the expected loss amount.

The treatment set out in this Article applies only where the exposure value is less than or equal to the value of the credit protection.

Nth-to-default credit derivatives.

241. Where the nth default among the exposures triggers payment under the credit protection, the institution purchasing the protection may only recognise the protection for the calculation of risk-weighted exposure amounts and, as applicable, expected loss amounts where protection has also been obtained for defaults 1 to n-1 or when n-1 defaults have already occurred. In such cases, the institution may amend the calculation of the risk-weighted exposure amount and, as applicable, the expected loss amount of the exposure which would, in the absence of the credit protection, produce the n-th lowest risk-weighted exposure amount in accordance with this Chapter. Institutions must calculate the nth lowest amount as specified in Article 240(a) and (b).

The treatment set out in this Article applies only where the exposure value is less than or equal to the value of the credit protection.

All exposures in the basket must meet the requirements laid down in Article 204(2) and Article 216(1)(d).

Definitions.

242. For the purposes of this Chapter, the following definitions apply–

"asset-backed commercial paper programme" or "ABCP programme" means an asset backed commercial paper programme or ABCP programme as defined in Article 2(7) of the Securitisation Regulation;

"asset-backed commercial paper transaction" or "ABCP transaction" means an asset-backed commercial paper transaction or ABCP transaction as defined in Article 2(8) of the Securitisation Regulation;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

"clean-up call option" means a contractual option that entitles the originator to call the securitisation positions before all of the securitised exposures have been repaid, either by repurchasing the underlying exposures remaining in the pool in the case of traditional securitisations or by terminating the credit protection in the case of synthetic securitisations, in both cases when the amount of outstanding underlying exposures falls to or below certain pre-specified level;

"credit-enhancing interest-only strip" means an on-balance sheet asset that represents a valuation of cash flows related to future margin income and is a subordinated tranche in the securitisation;

"early amortisation provision" means an early amortisation provision as defined in Article 2(17) of the Securitisation Regulation;

"first loss tranche" means a first loss tranche as defined in Article 2(18) of the Securitisation Regulation;

"IRB pool" means a pool of underlying exposures of a type in relation to which the institution has approval to use the IRB Approach and is able to calculate risk-weighted exposure amounts in accordance with Chapter 3 for all of these exposures;

"liquidity facility" means a liquidity facility as defined in Article 2(14) of the Securitisation Regulation;

"mezzanine securitisation position" means a position in the securitisation which is subordinated to the senior securitisation position and more senior than the first loss tranche, and which is subject to a risk weight lower than 1,250% and higher than 25% in accordance with Articles 254 to 266;

"mixed pool" means a pool of underlying exposures of a type in relation to which the institution has approval to use the IRB Approach and is able to calculate risk-weighted exposure amounts in accordance with Chapter 3 for some, but not all, of the exposures;

"promotional entity" means any undertaking or entity established by a central, regional or local government, which grants promotional loans or grants promotional guarantees, whose primary goal is not to make profit or maximise market share but to promote that government's public policy objectives, where that government has an obligation to protect the economic basis of the undertaking or entity and maintain its viability throughout its lifetime, or that at least 90% of its original capital or funding or the

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

promotional loan it grants is directly or indirectly guaranteed by the central, regional or local government;

"over-collateralisation" means any form of credit enhancement by virtue of which underlying exposures are posted in value which is higher than the value of the

"rated position" means a securitisation position which has an eligible credit assessment in accordance with Articles 270B to 270E;

"revolving exposure" means a revolving exposure as defined in Article 2(15) of the Securitisation Regulation;

"senior securitisation position" means a position backed or secured by a first claim on the whole of the underlying exposures, disregarding for these purposes amounts due under interest rate or currency derivative contracts, fees or other similar payments, and irrespective of any difference in maturity with one or more other senior tranches with which that position shares losses on a pro-rata basis;

"simple, transparent and standardised securitisation" or "STS securitisation" means a securitisation that meets the requirements set out in Article 18 of the Securitisation Regulation;

"synthetic securitisation" means a synthetic securitisation as defined in Article 2(10) of the Securitisation Regulation;

"traditional securitisation" means a traditional securitisation as defined in Article 2(9) of the Securitisation Regulation;

"unrated position" means a securitisation position which does not have an eligible credit assessment in accordance with Articles 270B to 270E.

Criteria for STS securitisations qualifying for differentiated capital treatment.

243.(1) Positions in an ABCP programme or ABCP transaction that qualify as positions in an STS securitisation must be eligible for the treatment set out in Articles 260, 262 and 264 where the following requirements are met–

(a) the underlying exposures meet, at the time of their inclusion in the ABCP programme, to the best knowledge of the originator or the original lender, the conditions for being assigned, under the Standardised Approach and taking into account any eligible credit risk mitigation, a risk weight equal to or smaller than

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

75% on an individual exposure basis where the exposure is a retail exposure or 100% for any other exposures; and

(b) the aggregate exposure value of all exposures to a single obligor at ABCP programme level does not exceed 2% of the aggregate exposure value of all exposures within the ABCP programme at the time the exposures were added to the ABCP programme. For the purposes of this calculation, loans or leases to a group of connected clients, to the best knowledge of the sponsor, are considered as exposures to a single obligor.

In the case of trade receivables, sub-paragraph (b) does not apply where the credit risk of those trade receivables is fully covered by eligible credit protection in accordance with Chapter 4 and the protection provider is an institution, an investment firm, an insurance undertaking or a reinsurance undertaking.

In the case of securitised residual leasing values, sub-paragraph (b) does not apply where those values are not exposed to refinancing or resell risk due to a legally enforceable commitment to repurchase or refinance the exposure at a pre-determined amount by a third party eligible under Article 201(1).

By way of derogation from sub-paragraph (a), where an institution applies Article 248(3) or has been granted approval to apply the Internal Assessment Approach in accordance with Article 265, the risk weight that institution would assign to a liquidity facility that completely covers the ABCP issued under the programme is equal to or smaller than 100%.

(2) Positions in a securitisation, other than an ABCP programme or ABCP transaction, that qualify as positions in an STS securitisation, are eligible for the treatment set out in Articles 260, 262 and 264 where the following requirements are met–

(a) at the time of inclusion in the securitisation, the aggregate exposure value of all exposures to a single obligor in the pool does not exceed 2% of the exposure values of the aggregate outstanding exposure values of the pool of underlying exposures. For the purposes of this calculation, loans or leases to a group of connected clients are considered as exposures to a single obligor.

In the case of securitised residual leasing values, the first sub-paragraph does not apply where those values are not exposed to refinancing or resell risk due to a legally enforceable commitment to repurchase or refinance the exposure at a pre-determined amount by a third party eligible under Article 201(1);

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(b) at the time of their inclusion in the securitisation, the underlying exposures meet the conditions for being assigned, under the Standardised Approach and taking into account any eligible credit risk mitigation, a risk weight equal to or smaller than–

(i) 40% on an exposure value-weighted average basis for the portfolio where the exposures are loans secured by residential mortgages or fully guaranteed residential loans, as referred to in Article 129(1)(e);

(ii) 50% on an individual exposure basis where the exposure is a loan secured by a commercial mortgage;

(iii) 75% on an individual exposure basis where the exposure is a retail exposure;

(iv) for any other exposures, 100% on an individual exposure basis;

(c) where sub-paragraphs (b)(i) and (b)(ii) apply, the loans secured by lower ranking security rights on a given asset are only included in the securitisation where all loans secured by prior ranking security rights on that asset are also included in the securitisation;

(d) where sub-paragraph (b)(i) applies, no loan in the pool of underlying exposures must have a loan-to-value ratio higher than 100%, at the time of inclusion in the securitisation, measured in accordance with Article 129(1)(d) and Article 229(1).

Recognition of significant risk transfer

Traditional securitisation.

244.(1) The originator institution of a traditional securitisation may exclude underlying exposures from its calculation of risk-weighted exposure amounts and, where relevant, expected loss amounts if either of the following conditions is fulfilled–

(a) significant credit risk associated with the underlying exposures has been transferred to third parties;

(b) the originator institution applies a 1,250% risk weight to all securitisation positions it holds in the securitisation or deducts these securitisation positions from Common Equity Tier 1 items in accordance with Article 36(1)(k).

(2) Significant credit risk is considered as transferred in either of the following cases–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) the risk-weighted exposure amounts of the mezzanine securitisation positions held by the originator institution in the securitisation do not exceed 50% of the risk-weighted exposure amounts of all mezzanine securitisation positions existing in this securitisation;

(b) the originator institution does not hold more than 20% of the exposure value of the first loss tranche in the securitisation, if both of the following conditions are met–

(i) the originator can demonstrate that the exposure value of the first loss tranche exceeds a reasoned estimate of the expected loss on the underlying exposures by a substantial margin;

(ii) there are no mezzanine securitisation positions.

Where the possible reduction in risk-weighted exposure amounts, which the originator institution would achieve by the securitisation under sub-paragraphs (a) or (b), is not justified by a commensurate transfer of credit risk to third parties, the GFSC may decide on a case-by-case basis that significant credit risk is not considered as transferred to third parties.

(3) By way of derogation from paragraph (2), the GFSC may allow originator institutions to recognise significant credit risk transfer in relation to a securitisation where the originator institution demonstrates in each case that the reduction in own funds requirements which the originator achieves by the securitisation is justified by a commensurate transfer of credit risk to third parties. Approval may only be granted where the institution meets both of the following conditions–

(a) the institution has adequate internal risk management policies and methodologies to assess the transfer of credit risk;

(b) the institution has also recognised the transfer of credit risk to third parties in each case for the purposes of the institution's internal risk management and its internal capital allocation.

(4) In addition to the requirements set out in paragraphs (1), (2) and (3), all of the following conditions must be met–

(a) the transaction documentation reflects the economic substance of the securitisation;

(b) the securitisation positions do not constitute payment obligations of the originator institution;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(c) the underlying exposures are placed beyond the reach of the originator institution and its creditors in a manner that meets the requirement set out in Article 20(1) of the Securitisation Regulation;

(d) the originator institution does not retain control over the underlying exposures. It must be considered that control is retained over the underlying exposures where the originator has the right to repurchase from the transferee the previously transferred exposures in order to realise their benefits or if it is otherwise required to re-assume transferred risk. The originator institution's retention of servicing rights or obligations in respect of the underlying exposures does not of itself constitute control of the exposures;

(e) the securitisation documentation does not contain terms or conditions that–

(i) require the originator institution to alter the underlying exposures to improve the average quality of the pool; or

(ii) increase the yield payable to holders of positions or otherwise enhance the positions in the securitisation in response to a deterioration in the credit quality of the underlying exposures;

(f) where applicable, the transaction documentation makes it clear that the originator or the sponsor may only purchase or repurchase securitisation positions or repurchase, restructure or substitute the underlying exposures beyond their contractual obligations where such arrangements are executed in accordance with prevailing market conditions and the parties to them act in their own interest as free and independent parties (arm's length);

(g) where there is a clean-up call option, that option must also meet all of the following conditions–

(i) it can be exercised at the discretion of the originator institution;

(ii) it may only be exercised when 10% or less of the original value of the underlying exposures remains unamortised;

(iii) it is not structured to avoid allocating losses to credit enhancement positions or other positions held by investors in the securitisation and is not otherwise structured to provide credit enhancement;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(h) the originator institution has received an opinion from a qualified legal counsel confirming that the securitisation complies with the conditions set out in sub-paragraph (c).

Synthetic securitisation.

245.(1) The originator institution of a synthetic securitisation may calculate risk-weighted exposure amounts, and, where relevant, expected loss amounts with respect to the underlying exposures in accordance with Articles 251 and 252, where either of the following conditions is met–

(a) significant credit risk has been transferred to third parties either through funded or unfunded credit protection;

(b) the originator institution applies a 1,250% risk weight to all securitisation positions that it retains in the securitisation or deducts these securitisation positions from Common Equity Tier 1 items in accordance with Article 36(1)(k).

(2) Significant credit risk is considered as transferred in either of the following cases–

(a) the risk-weighted exposure amounts of the mezzanine securitisation positions held by the originator institution in the securitisation do not exceed 50% of the risk-weighted exposure amounts of all mezzanine securitisation positions existing in this securitisation;

(b) the originator institution does not hold more than 20% of the exposure value of the first loss tranche in the securitisation, if both of the following conditions are met–

(i) the originator can demonstrate that the exposure value of the first loss tranche exceeds a reasoned estimate of the expected loss on the underlying exposures by a substantial margin;

(ii) there are no mezzanine securitisation positions.

Where the possible reduction in risk-weighted exposure amounts, which the originator institution would achieve by the securitisation, is not justified by a commensurate transfer of credit risk to third parties, the GFSC may decide on a case-by-case basis that significant credit risk is not considered as transferred to third parties.

(3) By way of derogation from paragraph (2), the GFSC may allow originator institutions to recognise significant credit risk transfer in relation to a securitisation where the originator institution demonstrates in each case that the reduction in own funds requirements which the

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

originator achieves by the securitisation is justified by a commensurate transfer of credit risk to third parties. Approval may only be granted where the institution meets both of the following conditions–

(a) the institution has adequate internal risk-management policies and methodologies to assess the transfer of risk;

(b) the institution has also recognised the transfer of credit risk to third parties in each case for the purposes of the institution's internal risk management and its internal capital allocation.

(4) In addition to the requirements set out in paragraphs (1), (2) and (3), all of the following conditions must be met–

(a) the transaction documentation reflects the economic substance of the securitisation;

(b) the credit protection by virtue of which credit risk is transferred complies with Article 249;

(c) the securitisation documentation does not contain terms or conditions that–

(i) impose significant materiality thresholds below which credit protection is deemed not to be triggered if a credit event occurs;

(ii) allow for the termination of the protection due to deterioration of the credit quality of the underlying exposures;

(iii) require the originator institution to alter the composition of the underlying exposures to improve the average quality of the pool; or

(iv) increase the institution's cost of credit protection or the yield payable to holders of positions in the securitisation in response to a deterioration in the credit quality of the underlying pool;

(d) the credit protection is enforceable in all relevant jurisdictions;

(e) where applicable, the transaction documentation makes it clear that the originator or the sponsor may only purchase or repurchase securitisation positions or repurchase, restructure or substitute the underlying exposures beyond their contractual obligations where such arrangements are executed in accordance with

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

prevailing market conditions and the parties to them act in their own interest as free and independent parties (arm's length);

(f) where there is a clean-up call option, that option meets all the following conditions–

(i) it may be exercised at the discretion of the originator institution;

(ii) it may only be exercised when 10% or less of the original value of the underlying exposures remains unamortised;

(iii) it is not structured to avoid allocating losses to credit enhancement positions or other positions held by investors in the securitisation and is not otherwise structured to provide credit enhancement;

(g) the originator institution has received an opinion from a qualified legal counsel confirming that the securitisation complies with the conditions set out in sub-paragraph (d).

Operational requirements for early amortisation provisions.

246. Where the securitisation includes revolving exposures and early amortisation provisions or similar provisions, significant credit risk is only considered transferred by the originator institution where the requirements laid down in Articles 244 and 245 are met and the early amortisation provision, once triggered, does not–

(a) subordinate the institution's senior or *pari passu* claim on the underlying exposures to the other investors' claims;

(b) subordinate further the institution's claim on the underlying exposures relative to other parties' claims; or

(c) otherwise increase the institution's exposure to losses associated with the underlying revolving exposures.

Calculation of risk-weighted exposure amounts

Calculation of risk-weighted exposure amounts.

247.(1) Where an originator institution has transferred significant credit risk associated with the underlying exposures of the securitisation in accordance with Articles 244 to 246, that institution may–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) in the case of a traditional securitisation, exclude the underlying exposures from its calculation of risk-weighted exposure amounts, and, as relevant, expected loss amounts;

(b) in the case of a synthetic securitisation, calculate risk-weighted exposure amounts, and, where relevant, expected loss amounts, with respect to the underlying exposures in accordance with Articles 251 and 252.

(2) Where the originator institution has decided to apply paragraph (1), it must calculate the risk-weighted exposure amounts as set out in this Chapter for the positions that it may hold in the securitisation.

Where the originator institution has not transferred significant credit risk or has decided not to apply paragraph (1), it is not required to calculate risk-weighted exposure amounts for any position it may have in the securitisation but must continue including the underlying exposures in its calculation of risk-weighted exposure amounts and, where relevant, expected loss amounts as if they had not been securitised.

(3) Where there is an exposure to positions in different tranches in a securitisation, the exposure to each tranche is considered a separate securitisation position. The providers of credit protection to securitisation positions are considered as holding positions in the securitisation. Securitisation positions must include exposures to a securitisation arising from interest rate or currency derivative contracts that the institution has entered into with the transaction.

(4) Unless a securitisation position is deducted from Common Equity Tier 1 items pursuant to Article 36(1)(k), the risk-weighted exposure amount is included in the institution's total of risk-weighted exposure amounts for the purposes of Article 92(3).

(5) The risk-weighted exposure amount of a securitisation position is calculated by multiplying the exposure value of the position, calculated as set out in Article 248, by the relevant total risk weight.

(6) The total risk weight is determined as the sum of the risk weight set out in this Chapter and any additional risk weight in accordance with Article 270A.

Exposure value.

248.(1) The exposure value of a securitisation position is calculated as follows–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) the exposure value of an on-balance sheet securitisation position is its accounting value remaining after any relevant specific credit risk adjustments on the securitisation position have been applied in accordance with Article 110;

(b) the exposure value of an off-balance sheet securitisation position must is its nominal value less any relevant specific credit risk adjustments on the securitisation position in accordance with Article 110, multiplied by the relevant conversion factor as set out in this sub-paragraph. The conversion factor is 100%, except in the case of cash advance facilities. To determine the exposure value of the undrawn portion of the cash advance facilities, a conversion factor of 0% may be applied to the nominal amount of a liquidity facility that is unconditionally cancellable if repayment of draws on the facility are senior to any other claims on the cash flows arising from the underlying exposures and the institution has demonstrated to the satisfaction of the GFSC that it is applying an appropriately conservative method for measuring the amount of the undrawn portion;

(c) the exposure value for the counterparty credit risk of a securitisation position that results from a derivative instrument listed in Schedule 2, is determined in accordance with Chapter 6;

(d) an originator institution may deduct from the exposure value of a securitisation position which is assigned 1,250% risk weight in accordance with Articles 258 to 266 or deducted from Common Equity Tier 1 in accordance with Article 36(1)(k), the amount of the specific credit risk adjustments on the underlying exposures in accordance with Article 110, and any non-refundable purchase price discounts connected with such underlying exposures to the extent that such discounts have caused the reduction of own funds.

(2) Where an institution has two or more overlapping positions in a securitisation, it must include only one of the positions in its calculation of risk-weighted exposure amounts.

Where the positions partially overlap, the institution may split the position into two parts and recognise the overlap in relation to one part only in accordance with the first sub-paragraph. Alternatively, the institution may treat the positions as if they were fully overlapping by expanding for capital calculation purposes the position that produces the higher risk-weighted exposure amounts.

The institution may also recognise an overlap between the specific risk own funds requirements for positions in the trading book and the own funds requirements for securitisation positions in the non-trading book, if the institution is able to calculate and compare the own funds requirements for the relevant positions.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

For the purposes of this paragraph, two positions are deemed to be overlapping where they are mutually offsetting in such a manner that the institution is able to preclude the losses arising from one position by performing the obligations required under the other position.

(3) Where Article 270C(d) applies to positions in an ABCP, the institution may use the risk weight assigned to a liquidity facility in order to calculate the risk-weighted exposure amount for the ABCP, if the liquidity facility covers 100% of the ABCP issued by the ABCP programme and the liquidity facility ranks *pari passu* with the ABCP in a manner that they form an overlapping position. The institution must notify the GFSC where it has applied the provisions laid down in this paragraph. For the purposes of determining the 100% coverage set out in this paragraph, the institution may take into account other liquidity facilities in the ABCP programme, if they form an overlapping position with the ABCP.

Recognition of credit risk mitigation for securitisation positions.

249.(1) An institution may recognise funded or unfunded credit protection with respect to a securitisation position where the requirements for credit risk mitigation laid down in this Chapter and in Chapter 4 are met.

(2) Eligible funded credit protection is limited to financial collateral which is eligible for the calculation of risk-weighted exposure amounts under Chapter 2 as laid down under Chapter 4 and recognition of credit risk mitigation is subject to compliance with the relevant requirements as laid down under Chapter 4.

Eligible unfunded credit protection and unfunded credit protection providers are limited to those which are eligible in accordance with Chapter 4 and recognition of credit risk mitigation is subject to compliance with the relevant requirements as laid down under Chapter 4.

(3) By way of derogation from paragraph (2), the eligible providers of unfunded credit protection listed in Article 201(1)(a) to (h) must have been assigned a credit assessment by a recognised ECAI which is credit quality step 2 or above at the time the credit protection was first recognised and credit quality step 3 or above thereafter. The requirement set out in this sub-paragraph does not apply to qualifying central counterparties.

Institutions which are allowed to apply the IRB Approach to a direct exposure to the protection provider may assess eligibility in accordance with the first sub-paragraph based on the equivalence of the PD for the protection provider to the PD associated with the credit quality steps referred to in Article 136.

(4) By way of derogation from paragraph (2), SSPEs are eligible protection providers where all of the following conditions are met–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) the SSPE owns assets that qualify as eligible financial collateral in accordance with Chapter 4;

(b) the assets referred to in sub-paragraph (a) are not subject to claims or contingent claims ranking ahead or *pari passu* with the claim or contingent claim of the institution receiving unfunded credit protection; and

(c) all the requirements for the recognition of financial collateral set out in Chapter 4 are met.

(5) For the purposes of paragraph (4), the amount of the protection adjusted for any currency and maturity mismatches (Ga) in accordance with Chapter 4 are limited to the volatility adjusted market value of those assets and the risk weight of exposures to the protection provider as specified under the Standardised Approach (g) are determined as the weighted-average risk weight that would apply to those assets as financial collateral under the Standardised Approach.

(6) Where a securitisation position benefits from full credit protection or a partial credit protection on a pro-rata basis, the following requirements must apply–

(a) the institution providing credit protection must calculate risk-weighted exposure amounts for the portion of the securitisation position benefiting from credit protection in accordance with Articles 258 to 266 as if it held that portion of the position directly;

(b) the institution buying credit protection must calculate risk-weighted exposure amounts in accordance with Chapter 4 for the protected portion.

(7) In all cases not covered by paragraph (6), the following requirements must apply–

(a) the institution providing credit protection must treat the portion of the position benefiting from credit protection as a securitisation position and must calculate risk-weighted exposure amounts as if it held that position directly in accordance with Articles 258 to 266, subject to paragraphs (8), (9) and (10);

(b) the institution buying credit protection must calculate risk-weighted exposure amounts for the protected portion of the position referred to in sub-paragraph (a) in accordance with Chapter 4. The institution must treat the portion of the securitisation position not benefiting from credit protection as a separate securitisation position and must calculate risk-weighted exposure amounts in accordance with Articles 258 to 266, subject to paragraphs (8), (9) and (10).

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(8) Institutions using the Securitisation Internal Ratings Based Approach (SEC-IRBA) or the Securitisation Standardised Approach (SEC-SA) under Articles 258 to 266 must determine the attachment point (A) and detachment point (D) separately for each of the positions derived in accordance with paragraph (7) as if these had been issued as separate securitisation positions at the time of origination of the transaction. The value of K IRB or K SA , respectively, is calculated taking into account the original pool of exposures underlying the securitisation.

(9) Institutions using the Securitisation External Ratings Based Approach (SEC-ERBA) under Articles 258 to 266 for the original securitisation position must calculate risk-weighted exposure amounts for the positions derived in accordance with paragraph (7) as follows–

(a) where the derived position has the higher seniority, it is assigned the risk weight of the original securitisation position;

(b) where the derived position has the lower seniority, it may be assigned an inferred rating in accordance with Article 263(7). In that case, thickness input T must only be computed on the basis of the derived position. Where a rating may not be inferred, the institution must apply the higher of the risk weight resulting from either–

(i) applying the SEC-SA in accordance with paragraph (8) and Articles 258 to 266; or

(ii) the risk weight of the original securitisation position under the SEC-ERBA.

(10) The derived position with the lower seniority is treated as a non-senior securitisation position even if the original securitisation position prior to protection qualifies as senior.

Implicit support.

250.(1) A sponsor institution, or an originator institution which in respect of a securitisation has made use of Article 247(1) and (2) in the calculation of risk-weighted exposure amounts or has sold instruments from its trading book to the effect that it is no longer required to hold own funds for the risks of those instruments must not provide support, directly or indirectly, to the securitisation beyond its contractual obligations with a view to reducing potential or actual losses to investors.

(2) A transaction must not be considered as support for the purposes of paragraph (1) where the transaction has been duly taken into account in the assessment of significant credit risk transfer and both parties have executed the transaction acting in their own interest as free and independent parties (arm's length). For these purposes, the institution must undertake a full credit review of the transaction and, at a minimum, take into account all of the following items–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) the repurchase price;

(b) the institution's capital and liquidity position before and after repurchase;

(c) the performance of the underlying exposures;

(d) the performance of the securitisation positions;

(e) the impact of support on the losses expected to be incurred by the originator relative to investors.

(3) The originator institution and the sponsor institution must notify the GFSC of any transaction entered into in relation to the securitisation in accordance with paragraph (2).

(4) [Not used]

(5) If an originator institution or a sponsor institution fails to comply with paragraph (1) in respect of a securitisation, the institution must include all of the underlying exposures of that securitisation in its calculation of risk-weighted exposure amounts as if they had not been securitised and disclose–

(a) that it has provided support to the securitisation in breach of paragraph (1); and

(b) the impact of the support provided in terms of own funds requirements.

Originator institutions' calculation of risk-weighted exposure amounts securitised in a synthetic securitisation.

251.(1) For the purpose of calculating risk-weighted exposure amounts for the underlying exposures, the originator institution of a synthetic securitisation must use the calculation methodologies set out in Articles 247 to 270Awhere applicable instead of those set out in Chapter 2. For institutions calculating risk-weighted exposure amounts and, where relevant, expected loss amounts with respect to the underlying exposures under Chapter 3, the expected loss amount in respect of such exposures must be zero.

(2) The requirements set out in paragraph (1) must apply to the entire pool of exposures backing the securitisation. Subject to Article 252, the originator institution must calculate risk-weighted exposure amounts with respect to all tranches in the securitisation in accordance with Articles 247 to 270A, including the positions in relation to which the institution is able to recognise credit risk mitigation in accordance with Article 249. The risk weight to be applied

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

to positions which benefit from credit risk mitigation may be amended in accordance with Chapter 4.

Treatment of maturity mismatches in synthetic securitisations.

252. For the purposes of calculating risk-weighted exposure amounts in accordance with Article 251, any maturity mismatch between the credit protection by which the transfer of risk is achieved and the underlying exposures are calculated as follows–

(a) the maturity of the underlying exposures are taken to be the longest maturity of any of those exposures subject to a maximum of 5 years. The maturity of the credit protection is determined in accordance with Chapter 4;

(b) an originator institution must ignore any maturity mismatch in calculating risk-weighted exposure amounts for securitisation positions subject to a risk weight of 1,250% in accordance with Articles 247 to 270A. For all other positions, the maturity mismatch treatment set out in Chapter 4 is applied in accordance with the following formula–

$$RW^* = RW_{SP} \cdot [(t - t^*)/(T - t^*)] + RW_{Ass} \cdot [(T - t)/(T - t^*)]$$

where–

RW^* = risk-weighted exposure amounts for the purposes of Article 92(3)(a);

RW_{Ass} = risk-weighted exposure amounts for the underlying exposures as if they had not been securitised, calculated on a pro-rata basis;

RW_{SP} = risk-weighted exposure amounts calculated under Article 251 as if there was no maturity mismatch;

T = maturity of the underlying exposures, expressed in years;

t = maturity of credit protection, expressed in years;

$t^* = 0.25$

Reduction in risk-weighted exposure amounts.

253.(1) Where a securitisation position is assigned a 1,250% risk weight under Articles 247 to 270A, institutions may deduct the exposure value of such position from Common Equity

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Tier 1 capital in accordance with Article 36(1)(k) as an alternative to including the position in their calculation of risk-weighted exposure amounts. For that purpose, the calculation of the exposure value may reflect eligible funded credit protection in accordance with Article 249.

(2) Where an institution makes use of the alternative set out in paragraph (1), it may subtract the amount deducted in accordance with Article 36(1)(k) from the amount specified in Article 268 as maximum capital requirement that would be calculated in respect of the underlying exposures as if they had not been securitised.

Hierarchy of methods.

254.(1) Institutions must use one of the methods set out in Articles 258 to 266 to calculate risk-weighted exposure amounts in accordance with the following hierarchy–

(a) where the conditions set out in Article 258 are met, an institution must use the SEC-IRBA in accordance with Articles 259 and 260;

(b) where the SEC-IRBA may not be used, an institution must use the SEC-SA in accordance with Articles 261 and 262;

(c) where the SEC-SA may not be used, an institution must use the SEC-ERBA in accordance with Articles 263 and 264 for rated positions or positions in respect of which an inferred rating may be used.

(2) For rated positions or positions in respect of which an inferred rating may be used, an institution must use the SEC-ERBA instead of the SEC-SA in each of the following cases–

(a) where the application of the SEC-SA would result in a risk weight higher than 25% for positions qualifying as positions in an STS securitisation;

(b) where the application of the SEC-SA would result in a risk weight higher than 25% or the application of the SEC-ERBA would result in a risk weight higher than 75% for positions not qualifying as positions in an STS securitisation;

(c) for securitisation transactions backed by pools of auto loans, auto leases and equipment leases.

(3) [Not used]

(4) By way of derogation from paragraph (1), GFSC may prohibit institutions, on a case by case basis, from applying the SEC-SA when the risk-weighted exposure amount resulting from the application of the SEC-SA is not commensurate to the risks posed to the institution or to

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

financial stability, including but not limited to the credit risk embedded in the exposures underlying the securitisation. In the case of exposures not qualifying as positions in an STS securitisation, particular regard must be had to securitisations with highly complex and risky features.

(5) Without prejudice to paragraph (1), an institution may apply the Internal Assessment Approach to calculate risk-weighted exposure amounts in relation to an unrated position in an ABCP programme or ABCP transaction in accordance with Article 266, if the conditions set out in Article 265 are met. Where an institution has received approval to apply the Internal Assessment Approach in accordance with Article 265(2), and a specific position in an ABCP programme or ABCP transaction falls within the scope of application covered by such approval, the institution must apply that approach to calculate the risk-weighted exposure amount of that position.

(6) For a position in a re-securitisation, institutions must apply the SEC-SA in accordance with Article 261, with the modifications set out in Article 269.

(7) In all other cases, a risk weight of 1,250% is assigned to securitisation positions.

Determination of K IRB and K SA.

255.(1) Where an institution applies the SEC-IRBA under Articles 258 to 266, the institution must calculate K IRB in accordance with paragraphs (2) to (5).

(2) Institutions must determine K IRB by multiplying the risk-weighted exposure amounts that would be calculated under Chapter 3 in respect of the underlying exposures as if they had not been securitised by 8% divided by the exposure value of the underlying exposures. K IRB is expressed in decimal form between zero and one.

(3) For K IRB calculation purposes, the risk-weighted exposure amounts that would be calculated under Chapter 3 in respect of the underlying exposures must include–

(a) the amount of expected losses associated with all the underlying exposures of the securitisation including defaulted underlying exposures that are still part of the pool in accordance with Chapter 3; and

(b) the amount of unexpected losses associated with all the underlying exposures including defaulted underlying exposures in the pool in accordance with Chapter 3.

(4) Institutions may calculate K IRB in relation to the underlying exposures of the securitisation in accordance with the provisions set out in Chapter 3 for the calculation of

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

capital requirements for purchased receivables. For these purposes, retail exposures are treated as purchased retail receivables and non-retail exposures as purchased corporate receivables.

(5) Institutions must calculate K IRB separately for dilution risk in relation to the underlying exposures of a securitisation where dilution risk is material to such exposures.

Where losses from dilution and credit risks are treated in an aggregate manner in the securitisation, institutions must combine the respective K IRB for dilution and credit risk into a single K IRB for the purposes of Articles 258 to 266. The presence of a single reserve fund or over-collateralisation available to cover losses from either credit or dilution risk may be regarded as an indication that these risks are treated in an aggregate manner.

Where dilution and credit risk are not treated in an aggregate manner in the securitisation, institutions must modify the treatment set out in the second sub-paragraph to combine the respective K IRB for dilution and credit risk in a prudent manner.

(6) Where an institution applies the SEC-SA under Articles 258 to 266, it must calculate K SA by multiplying the risk-weighted exposure amounts that would be calculated under Chapter 2 in respect of the underlying exposures as if they had not been securitised by 8% divided by the value of the underlying exposures. K SA is expressed in decimal form between zero and one.

For the purposes of this paragraph, institutions must calculate the exposure value of the underlying exposures without netting any specific credit risk adjustments and additional value adjustments in accordance with Articles 34 and 110 and other own funds reductions.

(7) For the purposes of paragraphs (1) to (6), where a securitisation structure involves the use of an SSPE, all the SSPE's exposures related to the securitisation are treated as underlying exposures. Without prejudice to the preceding, the institution may exclude the SSPE's exposures from the pool of underlying exposures for K IRB or K SA calculation purposes if the risk from the SSPE's exposures is immaterial or if it does not affect the institution's securitisation position.

In the case of funded synthetic securitisations, any material proceeds from the issuance of credit-linked notes or other funded obligations of the SSPE that serve as collateral for the repayment of the securitisation positions must be included in the calculation of K IRB or K SA if the credit risk of the collateral is subject to the tranched loss allocation.

(8) to (9) [Not used]

Determination of attachment point (A) and detachment point (D).

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

256.(1) For the purposes of Articles 258 to 266, institutions must set the attachment point (A) at the threshold at which losses within the pool of underlying exposures would start to be allocated to the relevant securitisation position.

The attachment point (A) is expressed as a decimal value between zero and one and must be equal to the greater of zero and the ratio of the outstanding balance of the pool of underlying exposures in the securitisation minus the outstanding balance of all tranches that rank senior or *pari passu* to the tranche containing the relevant securitisation position including the exposure itself to the outstanding balance of all the underlying exposures in the securitisation.

(2) For the purposes of Articles 258 to 266, institutions must set the detachment point (D) at the threshold at which losses within the pool of underlying exposures would result in a complete loss of principal for the tranche containing the relevant securitisation position.

The detachment point (D) is expressed as a decimal value between zero and one and must be equal to the greater of zero and the ratio of the outstanding balance of the pool of underlying exposures in the securitisation minus the outstanding balance of all tranches that rank senior to the tranche containing the relevant securitisation position to the outstanding balance of all the underlying exposures in the securitisation.

(3) For the purposes of paragraphs (1) and (2), institutions must treat over-collateralisation and funded reserve accounts as tranches and the assets comprising such reserve accounts as underlying exposures.

(4) For the purposes of paragraphs (1) and (2), institutions must disregard unfunded reserve accounts and assets that do not provide credit enhancement, such as those that only provide liquidity support, currency or interest rate swaps and cash collateral accounts related to those positions in the securitisation. For funded reserve accounts and assets providing credit enhancement, the institution must only treat as securitisation positions the parts of those accounts or assets that are loss-absorbing.

(5) Where two or more positions of the same transaction have different maturities but share pro rata loss allocation, the calculation of the attachment points (A) and the detachment points (D) are based on the aggregated outstanding balance of those positions and the resulting attachment points (A) and detachment points (D) must be the same.

Determination of tranche maturity (M T).

257.(1) For the purposes of Articles 258 to 266 and subject to paragraph (2), institutions may measure the maturity of a tranche (M T) as either–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) the weighted average maturity of the contractual payments due under the tranche in accordance with the following formula–

$$\sum_t t \cdot CF_t / \sum_t CF_t,$$

where CF t denotes all contractual payments (principal, interests and fees) payable by the borrower during period t; or

(b) the final legal maturity of the tranche in accordance with the following formula–

$$M_T = 1 + (M_L - 1) * 80\%,$$

where M L is the final legal maturity of the tranche.

(2) For the purposes of paragraph (1), the determination of a tranche maturity (M T) are subject in all cases to a floor of 1 year and a cap of 5 years.

(3) Where an institution may become exposed to potential losses from the underlying exposures by virtue of contract, the institution must determine the maturity of the securitisation position by taking into account the maturity of the contract plus the longest maturity of such underlying exposures. For revolving exposures, the longest contractually possible remaining maturity of the exposure that might be added during the revolving period applies.

Conditions for the use of the Internal Ratings Based Approach (SEC-IRBA).

258.(1) Institutions must use the SEC-IRBA to calculate risk-weighted exposure amounts in relation to a securitisation position where the following conditions are met–

(a) the position is backed by an IRB pool or a mixed pool, if, in the latter case, the institution is able to calculate K IRB in accordance with Articles 247 to 270A on a minimum of 95% of the underlying exposure amount;

(b) there is sufficient information available in relation to the underlying exposures of the securitisation for the institution to be able to calculate K IRB; and

(c) the institution has not been precluded from using the SEC-IRBA in relation to a specified securitisation position in accordance with paragraph (2).

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(2) The GFSC may on a case-by-case basis preclude the use of the SEC-IRBA where securitisations have highly complex or risky features. For these purposes, the following may be regarded as highly complex or risky features–

(a) credit enhancement that can be eroded for reasons other than portfolio losses;

(b) pools of underlying exposures with a high degree of internal correlation as a result of concentrated exposures to single sectors or geographical areas;

(c) transactions where the repayment of the securitisation positions is highly dependent on risk drivers not reflected in K IRB; or

(d) highly complex loss allocations between tranches.

Calculation of risk-weighted exposure amounts under the SEC-IRBA.

259.(1) Under the SEC-IRBA, the risk-weighted exposure amount for a securitisation position is calculated by multiplying the exposure value of the position calculated in accordance with Article 248 by the applicable risk weight determined as follows, in all cases subject to a floor of 15%–

$RW = 1\ 250\ \%$	when $D \leq K_{IRB}$
$RW = 12{,}5 \cdot K_{SSFA(K_{IRB})}$	when $A \geq K_{IRB}$
$RW = \left[\left(\frac{K_{IRB}-A}{D-A}\right) \cdot 12.5\right] + \left[\left(\frac{D-K_{IRB}}{D-A}\right) \cdot 12.5 \cdot K_{SSFA(K_{IRB})}\right]$	when $A < K_{IRB} < D$

where–

K IRB is the capital charge of the pool of underlying exposures as defined in Article 255

D is the detachment point as determined in accordance with Article 256

A is the attachment point as determined in accordance with Article 256

$$K_{SSFA(K_{IRB})} = \frac{e^{a \cdot u} - e^{a \cdot l}}{a(u-l)}$$

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

where–

a = – (1/(p * K IRB))

u = D – K IRB

l = max (A – K IRB ; 0)

where–

$$p = \max\left[0{,}3; \left(A + B^{*}(1/N) + C^{*}K_{IRB} + D^{*}LGD + E^{*}M_{T}\right)\right]$$

where–

N is the effective number of exposures in the pool of underlying exposures, calculated in accordance with paragraph (4);

LGD is the exposure-weighted average loss-given-default of the pool of underlying exposures, calculated in accordance with paragraph (5);

M T is the maturity of the tranche as determined in accordance with Article 257.

The parameters A, B, C, D, and E is determined according to the following look-up table–

		A	B	C	D	E
Non-retail	Senior, granular (N ≥ 25)	0	3,56	-1,85	0,55	0,07
	Senior, non-granular (N < 25)	0,11	2,61	-2,91	0,68	0,07
	Non-senior, granular (N ≥ 25)	0,16	2,87	-1,03	0,21	0,07
	Non-senior, non-granular (N < 25)	0,22	2,35	-2,46	0,48	0,07
Retail	Senior	0	0	-7,48	0,71	0,24
	Non-senior	0	0	-5,78	0,55	0,27

(2) If the underlying IRB pool comprises both retail and non-retail exposures, the pool is divided into one retail and one non-retail sub-pool and, for each sub-pool, a separate p-parameter (and the corresponding input parameters N, K IRB and LGD) must be estimated.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Subsequently, a weighted average p-parameter for the transaction is calculated on the basis of the p-parameters of each sub-pool and the nominal size of the exposures in each sub-pool.

(3) Where an institution applies the SEC-IRBA to a mixed pool, the calculation of the p-parameter is based on the underlying exposures subject to the IRB Approach only. The underlying exposures subject to the Standardised Approach is ignored for these purposes.

(4) The effective number of exposures (N) is calculated as follows–

$$N = \frac{\left(\sum_i \mathrm{EAD}_i\right)^2}{\sum_i \mathrm{EAD}^i_2}$$

where EAD_i represents the exposure value associated with the ith exposure in the pool.

Multiple exposures to the same obligor are consolidated and treated as a single exposure.

(5) The exposure-weighted average LGD is calculated as follows–

$$\mathrm{LGD} = \frac{\sum_i \mathrm{LGD}_i \cdot \mathrm{EAD}_i}{\sum_i \mathrm{EAD}_i}$$

where LGD i represents the average LGD associated with all exposures to the ith obligor.

Where credit and dilution risks for purchased receivables are managed in an aggregate manner in a securitisation, the LGD input is construed as a weighted average of the LGD for credit risk and 100% LGD for dilution risk. The weights must be the stand-alone IRB Approach capital requirements for credit risk and dilution risk, respectively. For these purposes, the presence of a single reserve fund or over-collateralisation available to cover losses from either credit or dilution risk may be regarded as an indication that these risks are managed in an aggregate manner.

(6) Where the share of the largest underlying exposure in the pool (C 1) is no more than 3%, institutions may use the following simplified method to calculate N and the exposure-weighted average LGDs–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

$$N = \left(C_1 \cdot C_m + \left(\frac{C_m - C_1}{m-1} \right) \cdot \max\left\{ 1 - m \cdot C_1, 0 \right\} \right)^{-1}$$

LGD = 0,50

where

C m denotes the share of the pool corresponding to the sum of the largest m exposures; and

m is set by the institution.

If only C 1 is available and this amount is no more than 0,03, then the institution may set LGD as 0.50 and N as 1/C 1 .

(7) Where the position is backed by a mixed pool and the institution is able to calculate K IRB on at least 95% of the underlying exposure amounts in accordance with Article 258(1)(a), the institution must calculate the capital charge for the pool of underlying exposures as–

$$d \cdot K_{IRB} + (1 - d) \cdot K_{SA},$$

where
d is the share of the exposure amount of underlying exposures for which the institution can calculate K IRB over the exposure amount of all underlying exposures.

(8) Where an institution has a securitisation position in the form of a derivative to hedge market risks, including interest rate or currency risks, the institution may attribute to that derivative an inferred risk weight equivalent to the risk weight of the reference position calculated in accordance with this Article.

For the purposes of the first sub-paragraph, the reference position must be the position that is *pari passu* in all respects to the derivative or, in the absence of such *pari passu* position, the position that is immediately subordinate to the derivative.

Treatment of STS securitisations under the SEC-IRBA.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

260. Under the SEC-IRBA, the risk weight for a position in an STS securitisation is calculated in accordance with Article 259, subject to the following modifications–

risk-weight floor for senior securitisation positions = 10%

$$p = \max\left[0{,}3;\ 0{,}5 \cdot \left(A + B \cdot (1/N) + C \cdot K_{IRB} + D \cdot LGD + E \cdot M_T\right)\right]$$

Calculation of risk-weighted exposure amounts under the Standardised Approach (SEC-SA).

261.(1) Under the SEC-SA, the risk-weighted exposure amount for a position in a securitisation is calculated by multiplying the exposure value of the position as calculated in accordance with Article 248 by the applicable risk weight determined as follows, in all cases subject to a floor of 15%–

RW = 1 250 %	when $D \leq K_A$
$RW = 12.5 \cdot K_{SSFA(K_A)}$	when $A \geq K_A$
$RW = \left[\left(\frac{K_A - A}{D - A}\right) \cdot 12.5\right] + \left[\left(\frac{D - K_A}{D - A}\right) \cdot 12.5 \cdot K_{SSFA(K_A)}\right]$	when $A < K_A < D$

where–

D is the detachment point as determined in accordance with Article 256;

A is the attachment point as determined in accordance with Article 256;

K A is a parameter calculated in accordance with paragraph (2);

$$K_{SSFA(K_A)} = \frac{e^{a \cdot u} - e^{a \cdot l}}{a(u - l)}$$

where–

a = – (1/(p · K A))

u = D – K A

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

l = max (A – K A ; 0)

p = 1 for a securitisation exposure that is not a re-securitisation exposure

(2) For the purposes of paragraph (1), K A is calculated as follows–

$$K_A = (1 - W) \cdot K_{SA} + W \cdot 0.5$$

where–

K SA is the capital charge of the underlying pool as defined in Article 255;

W = ratio of–

(a) the sum of the nominal amount of underlying exposures in default, to

(b) the sum of the nominal amount of all underlying exposures.

For these purposes, an exposure in default must mean an underlying exposure which is either–

(i) 90 days or more past due;

(ii) subject to bankruptcy or insolvency proceedings;

(iii) subject to foreclosure or similar proceeding; or

(iv) in default in accordance with the securitisation documentation.

Where an institution does not know the delinquency status for 5% or less of underlying exposures in the pool, the institution may use the SEC-SA subject to the following adjustment in the calculation K A –

$$K_A = \left(\frac{EAD_{\text{Subpool 1 where W known}}}{\text{EAD Total}} \times K^A_{\text{Subpool 1 where W known}}\right) + \frac{EAD_{\text{Subpool 2 where W unknown}}}{\text{EAD Total}}$$

Where the institution does not know the delinquency status for more than 5% of underlying exposures in the pool, the position in the securitisation is risk-weighted at 1,250%.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(3) Where an institution has a securitisation position in the form of a derivative to hedge market risks, including interest rate or currency risks, the institution may attribute to that derivative an inferred risk weight equivalent to the risk weight of the reference position calculated in accordance with this Article.

For the purposes of this paragraph, the reference position is the position that is *pari passu* in all respects to the derivative or, in the absence of such *pari passu* position, the position that is immediately subordinate to the derivative.

Treatment of STS securitisations under the SEC-SA.

262. Under the SEC-SA the risk weight for a position in an STS securitisation is calculated in accordance with Article 261, subject to the following modifications–

risk-weight floor for senior securitisation positions = 10%

p = 0.5

Calculation of risk-weighted exposure amounts under the External Ratings Based Approach (SEC-ERBA).

263.(1) Under the SEC-ERBA, the risk-weighted exposure amount for a securitisation position is calculated by multiplying the exposure value of the position as calculated in accordance with Article 248 by the applicable risk weight in accordance with this Article.

(2) For exposures with short-term credit assessments or when a rating based on a short-term credit assessment may be inferred in accordance with paragraph (7), the following risk weights must apply–

Table 1

Credit Quality Step	1	2	3	All other ratings
Risk weight	15 %	50 %	100 %	1 250 %

(3) For exposures with long-term credit assessments or when a rating based on a long-term credit assessment may be inferred in accordance with paragraph (7), the risk weights set out in Table 2 must apply, adjusted as applicable for tranche maturity (M_T) in accordance with

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Article 257 and paragraph (4) and for tranche thickness for non-senior tranches in accordance with paragraph (5)–

Table 2

Credit Quality Step	Senior tranche		Non-senior (thin) tranche	
	Tranche maturity (M_T)		Tranche maturity (M_T)	
	1 year	5 years	1 year	5 years
1	15 %	20 %	15 %	70 %
2	15 %	30 %	15 %	90 %
3	25 %	40 %	30 %	120 %
4	30 %	45 %	40 %	140 %
5	40 %	50 %	60 %	160 %
6	50 %	65 %	80 %	180 %
7	60 %	70 %	120 %	210 %
8	75 %	90 %	170 %	260 %
9	90 %	105 %	220 %	310 %
10	120 %	140 %	330 %	420 %
11	140 %	160 %	470 %	580 %
12	160 %	180 %	620 %	760 %
13	200 %	225 %	750 %	860 %
14	250 %	280 %	900 %	950 %
15	310 %	340 %	1 050 %	1 050 %
16	380 %	420 %	1 130 %	1 130 %
17	460 %	505 %	1 250 %	1 250 %
All other	1 250 %	1 250 %	1 250 %	1 250 %

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(4) In order to determine the risk weight for tranches with a maturity between 1 and 5 years, institutions must use linear interpolation between the risk weights applicable for 1 and 5 years maturity respectively in accordance with Table 2.

(5) In order to account for tranche thickness, institutions must calculate the risk weight for non-senior tranches as follows–

$$RW = [RW \text{ after adjusting for maturity according to paragraph 4}] \cdot [1 - \min(T; 50\,\%)]$$

where

T = tranche thickness measured as D – A

where

D is the detachment point as determined in accordance with Article 256

A is the attachment point as determined in accordance with Article 256

(6) The risk weights for non-senior tranches resulting from paragraphs (3), (4) and (5) are subject to a floor of 15%. In addition, the resulting risk weights must be no lower than the risk weight corresponding to a hypothetical senior tranche of the same securitisation with the same credit assessment and maturity.

(7) For the purposes of using inferred ratings, institutions must attribute to an unrated position an inferred rating equivalent to the credit assessment of a rated reference position which meets all of the following conditions–

(a) the reference position ranks *pari passu* in all respects to the unrated securitisation position or, in the absence of a *pari passu* ranking position, the reference position is immediately subordinate to the unrated position;

(b) the reference position does not benefit from any third-party guarantees or other credit enhancements that are not available to the unrated position;

(c) the maturity of the reference position must be equal to or longer than that of the unrated position in question;

(d) on an ongoing basis, any inferred rating must be updated to reflect any changes in the credit assessment of the reference position.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(8) Where an institution has a securitisation position in the form of a derivative to hedge market risks, including interest rate or currency risks, the institution may attribute to that derivative an inferred risk weight equivalent to the risk weight of the reference position calculated in accordance with this Article.

For the purposes of the first sub-paragraph, the reference position must be the position that is *pari passu* in all respects to the derivative or, in the absence of such *pari passu* position, the position that is immediately subordinate to the derivative.

Treatment of STS securitisations under the SEC-ERBA.

264.(1) Under the SEC-ERBA, the risk weight for a position in an STS securitisation is calculated in accordance with Article 263, subject to the modifications laid down in this Article.

(2) For exposures with short-term credit assessments or when a rating based on a short-term credit assessment may be inferred in accordance with Article 263(7), the following risk weights must apply–

Table 3

Credit Quality Step	1	2	3	All other ratings
Risk weight	10 %	30 %	60 %	1 250 %

(3) For exposures with long-term credit assessments or when a rating based on a long-term credit assessment may be inferred in accordance with Article 263(7), risk weights is determined in accordance with Table 4, adjusted for tranche maturity (M T) in accordance with Article 257 and Article 263(4) and for tranche thickness for non-senior tranches in accordance with Article 263(5)–

Table 4

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Credit Quality Step	Senior tranche		Non-senior (thin) tranche	
	Tranche maturity (M_T)		Tranche maturity (M_T)	
	1 year	5 years	1 year	5 years
1	10 %	10 %	15 %	40 %
2	10 %	15 %	15 %	55 %
3	15 %	20 %	15 %	70 %
4	15 %	25 %	25 %	80 %
5	20 %	30 %	35 %	95 %
6	30 %	40 %	60 %	135 %
7	35 %	40 %	95 %	170 %
8	45 %	55 %	150 %	225 %
9	55 %	65 %	180 %	255 %
10	70 %	85 %	270 %	345 %
11	120 %	135 %	405 %	500 %
12	135 %	155 %	535 %	655 %
13	170 %	195 %	645 %	740 %
14	225 %	250 %	810 %	855 %
15	280 %	305 %	945 %	945 %
16	340 %	380 %	1 015 %	1 015 %
17	415 %	455 %	1 250 %	1 250 %
All other	1 250 %	1 250 %	1 250 %	1 250 %

Scope and operational requirements for the Internal Assessment Approach.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

265.(1) Institutions may calculate the risk-weighted exposure amounts for unrated positions in ABCP programmes or ABCP transactions under the Internal Assessment Approach in accordance with Article 266 where the conditions set out in paragraph (2) are met.

Where an institution has received approval to apply the Internal Assessment Approach in accordance with paragraph (2), and a specific position in an ABCP programme or ABCP transaction falls within the scope of application covered by such approval, the institution must apply that approach to calculate the risk-weighted exposure amount of that position.

(2) The GFSC, when deciding to grant institutions approval to apply the Internal Assessment Approach within a clearly defined scope of application, must consider whether all of the following conditions are met–

(a) all positions in the commercial paper issued from the ABCP programme are rated positions;

(b) the internal assessment of the credit quality of the position reflects the publicly available assessment methodology of one or more ECAIs for the rating of securitisation positions backed by underlying exposures of the type securitised;

(c) the commercial paper issued from the ABCP programme is predominantly issued to third-party investors;

(d) the institution's internal assessment process is at least as conservative as the publicly available assessments of those ECAIs which have provided an external rating for the commercial paper issued from the ABCP programme, in particular with regard to stress factors and other relevant quantitative elements;

(e) the institution's internal assessment methodology takes into account all relevant publicly available rating methodologies of the ECAIs that rate the commercial paper of the ABCP programme and includes rating grades corresponding to the credit assessments of ECAIs. The institution must document in its internal records an explanatory statement describing how the requirements set out in this sub-paragraph have been met and must update such statement on a regular basis;

(f) the institution uses the internal assessment methodology for internal risk management purposes, including in its decision-making, management information and internal capital allocation processes;

(g) internal or external auditors, an ECAI, or the institution's internal credit review or risk management function perform regular reviews of the internal assessment

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

process and the quality of the internal assessments of the credit quality of the institution's exposures to an ABCP programme or ABCP transaction;

(h) the institution tracks the performance of its internal ratings over time to evaluate the performance of its internal assessment methodology and makes adjustments, as necessary, to that methodology when the performance of the exposures routinely diverges from that indicated by the internal ratings;

(i) the ABCP programme includes underwriting and liability management standards in the form of guidelines to the programme administrator on, at least–

(i) the asset eligibility criteria, subject to sub-paragraph (j);

(ii) the types and monetary value of the exposures arising from the provision of liquidity facilities and credit enhancements;

(iii) the loss distribution between the securitisation positions in the ABCP programme or ABCP transaction;

(iv) the legal and economic isolation of the transferred assets from the entity selling the assets;

(j) the asset eligibility criteria in the ABCP programme provide for, at least–

(i) exclusion of the purchase of assets that are significantly past due or defaulted;

(ii) limitation of excessive concentration to individual obligor or geographic area; and

(iii) limitation of the tenor of the assets to be purchased;

(k) an analysis of the asset seller's credit risk and business profile is performed including, at least, an assessment of the seller's–

(i) past and expected future financial performance;

(ii) current market position and expected future competitiveness;

(iii) leverage, cash flow, interest coverage and debt rating; and

(iv) underwriting standards, servicing capabilities, and collection processes;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(l) the ABCP programme has collection policies and processes that take into account the operational capability and credit quality of the servicer and comprises features that mitigate performance-related risks of the seller and the servicer. For the purposes of this sub-paragraph, performance-related risks may be mitigated through triggers based on the seller or servicer's current credit quality to prevent commingling of funds in the event of the seller's or servicer's default;

(m) the aggregated estimate of loss on an asset pool that may be purchased under the ABCP programme takes into account all sources of potential risk, such as credit and dilution risk;

(n) where the seller-provided credit enhancement is sized based only on credit-related losses and dilution risk is material for the particular asset pool, the ABCP programme comprises a separate reserve for dilution risk;

(o) the size of the required enhancement level in the ABCP programme is calculated taking into account several years of historical information, including losses, delinquencies, dilutions, and the turnover rate of the receivables;

(p) the ABCP programme comprises structural features in the purchase of exposures in order to mitigate potential credit deterioration of the underlying portfolio. Such features may include wind-down triggers specific to a pool of exposures;

(q) the institution evaluates the characteristics of the underlying asset pool, such as its weighted-average credit score, and identifies any concentrations to an individual obligor or geographic area and the granularity of the asset pool.

(3) Where the institution's internal audit, credit review, or risk management functions perform the review provided for in paragraph (2)(g), those functions must be independent from the institution's internal functions dealing with ABCP programme business and customer relations.

(4) Institutions which have received approval to apply the Internal Assessment Approach must not revert to the use of other methods for positions that fall within scope of application of the Internal Assessment Approach unless both of the following conditions are met–

(a) the institution has demonstrated to the satisfaction of the GFSC that the institution has good cause to do so;

(b) the institution has received GFSC approval.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Calculation of risk-weighted exposure amounts under the Internal Assessment Approach.

266.(1) Under the Internal Assessment Approach, the institution must assign the unrated position in the ABCP programme or ABCP transaction to one of the rating grades laid down in Article 265(2)(e) on the basis of its internal assessment. The position is attributed a derived rating which must be the same as the credit assessments corresponding to that rating grade as laid down in Article 265(2)(e).

(2) The rating derived in accordance with paragraph (1) must be at least at the level of investment grade or better at the time it was first assigned and is regarded as an eligible credit assessment by an ECAI for the purposes of calculating risk-weighted exposure amounts in accordance with Article 263 or Article 264, as applicable.

Maximum risk weight for senior securitisation positions– look-through approach.

267.(1) An institution which has knowledge at all times of the composition of the underlying exposures may assign the senior securitisation position a maximum risk weight equal to the exposure-weighted-average risk weight that would be applicable to the underlying exposures as if the underlying exposures had not been securitised.

(2) In the case of pools of underlying exposures where the institution uses exclusively the Standardised Approach or the IRB Approach, the maximum risk weight of the senior securitisation position must be equal to the exposure-weighted-average risk weight that would apply to the underlying exposures under Chapter 2 or 3, respectively, as if they had not been securitised.

In the case of mixed pools the maximum risk weight is calculated as follows–

(a) where the institution applies the SEC-IRBA, the Standardised Approach portion and the IRB Approach portion of the underlying pool must each be assigned the corresponding Standardised Approach risk weight and IRB Approach risk weight respectively;

(b) where the institution applies the SEC-SA or the SEC-ERBA, the maximum risk weight for senior securitisation positions must be equal to the Standardised Approach weighted-average risk weight of the underlying exposures.

(3) For the purposes of this Article, the risk weight that would be applicable under the IRB Approach in accordance with Chapter 3 must include the ratio of–

(a) expected losses multiplied by 12.5 to

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(b) the exposure value of the underlying exposures.

(4) Where the maximum risk weight calculated in accordance with paragraph (1) results in a lower risk weight than the risk-weight floors set out in Articles 259 to 264, as applicable, the former is used instead.

Maximum capital requirements.

268.(1) An originator institution, a sponsor institution or other institution using the SEC-IRBA or an originator institution or sponsor institution using the SEC-SA or the SEC-ERBA may apply a maximum capital requirement for the securitisation position it holds equal to the capital requirements that would be calculated under Chapter 2 or 3 in respect of the underlying exposures had they not been securitised. For the purposes of this Article, the IRB Approach capital requirement must include the amount of the expected losses associated with those exposures calculated under Chapter 3 and that of unexpected losses.

(2) In the case of mixed pools, the maximum capital requirement is determined by calculating the exposure-weighted average of the capital requirements of the IRB Approach and Standardised Approach portions of the underlying exposures in accordance with paragraph (1).

(3) The maximum capital requirement is the result of multiplying the amount calculated in accordance with paragraphs (1) or (2) by the largest proportion of interest that the institution holds in the relevant tranches (V), expressed as a percentage and calculated as follows–

(a) for an institution that has one or more securitisation positions in a single tranche, V must be equal to the ratio of the nominal amount of the securitisation positions that the institution holds in that given tranche to the nominal amount of the tranche;

(b) for an institution that has securitisation positions in different tranches, V must be equal to the maximum proportion of interest across tranches. For these purposes, the proportion of interest for each of the different tranches is calculated as set out in sub-paragraph (a).

(4) When calculating the maximum capital requirement for a securitisation position in accordance with this Article, the entire amount of any gain on sale and credit-enhancing interest-only strips arising from the securitisation transaction is deducted from Common Equity Tier 1 items in accordance with Article 36(1)(k).

Re-securitisations.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

269.(1) For a position in a re-securitisation, institutions must apply the SEC-SA in accordance with Article 261, with the following changes–

(a) $W = 0$ for any exposure to a securitisation tranche within the pool of underlying exposures;

(b) $p = 1,5$;

(c) the resulting risk weight is subject to a risk-weight floor of 100%.

(2) K_{SA} for the underlying securitisation exposures is calculated in accordance with Articles 254 to 257.

(3) The maximum capital requirements set out in Articles 267 and 268 must not be applied to re-securitisation positions.

(4) Where the pool of underlying exposures consists of a mix of securitisation tranches and other types of assets, the K_A parameter must be determined as the nominal exposure weighted-average of the K_A calculated individually for each subset of exposures.

Senior positions in SME securitisations.

270. An originator institution may calculate the risk-weighted exposure amounts in respect of a securitisation position in accordance with Articles 260, 262 or 264, as applicable, where the following conditions are met–

(a) the securitisation meets the requirements for STS securitisation set out in Chapter 4 of the Securitisation Regulation as applicable, other than Article 20(1) to (6) of that Regulation;

(b) the position qualifies as the senior securitisation position;

(c) the securitisation is backed by a pool of exposures to undertakings, if at least 70% of those in terms of portfolio balance qualify as SMEs (within the meaning of Article 501) at the time of issuance of the securitisation or in the case of revolving securitisations at the time an exposure is added to the securitisation;

(d) the credit risk associated with the positions not retained by the originator institution is transferred through a guarantee or a counter-guarantee meeting the requirements for unfunded credit protection set out in Chapter 4 for the Standardised Approach to credit risk;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(e) the third party to which the credit risk is transferred is one or more of the following–

(i) a government or central bank, a multilateral development bank, an international organisation or a promotional entity, if the exposures to the guarantor or counter-guarantor qualify for a 0% risk weight under Chapter 2;

(ii) an institutional investor as defined in point (12) of Article 2 of the Securitisation Regulation if the guarantee or counter-guarantee is fully collateralised by cash on deposit with the originator institution.

Additional risk weight.

270A.(1) Where an institution does not meet the requirements in Chapter 2 of the Securitisation Regulation in any material respect by reason of negligence or omission by the institution, the competent authorities must impose a proportionate additional risk weight of no less than 250% of the risk weight, capped at 1,250%, which must apply to the relevant securitisation positions in the manner specified in Article 247(6) or Article 337(3) of these Standards respectively. The additional risk weight must progressively increase with each subsequent infringement of the due diligence and risk management provisions. The competent authorities must take into account the exemptions for certain securitisations provided for in Article 6(5) of the Securitisation Regulation by reducing the risk weight they would otherwise impose under this Article in respect of a securitisation to which Article 6(5) of the Securitisation Regulation applies.

(2) [Not used]

External credit assessments

Use of credit assessments by ECAIs.

270B. Institutions may use only credit assessments to determine the risk weight of a securitisation position in accordance with this Chapter where the credit assessment has been issued or has been endorsed by an ECAI in accordance with the CRA Regulation.

Requirements to be met by the credit assessments of ECAIs.

270C. For the purposes of calculating risk-weighted exposure amounts in accordance with Articles 247 to 270A, institutions must only use a credit assessment of an ECAI where all of the following conditions are met–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) there is no mismatch between the types of payments reflected in the credit assessment and the types of payments to which the institution is entitled under the contract giving rise to the securitisation position in question;

(b) the ECAI publishes the credit assessments and information on loss and cash-flow analysis, sensitivity of ratings to changes in the underlying ratings assumptions, including the performance of underlying exposures, and on the procedures, methodologies, assumptions, and key elements underpinning the credit assessments in accordance with the CRA Regulation. For the purposes of this sub-paragraph, information is considered as publicly available where it is published in accessible format. Information that is made available only to a limited number of entities is not considered as publicly available;

(c) the credit assessments are included in the ECAI's transition matrix;

(d) the credit assessments are not based or partly based on unfunded support provided by the institution itself. Where a position is based or partly based on unfunded support, the institution must consider that position as if it were unrated for the purposes of calculating risk-weighted exposure amounts for this position in accordance with Articles 247 to 270A;

(e) the ECAI has committed to publishing explanations on how the performance of underlying exposures affects the credit assessment.

Use of credit assessments.

270D.(1) An institution may decide to nominate one or more ECAIs the credit assessments of which must be used in the calculation of its risk-weighted exposure amounts under this Chapter (a "nominated ECAI").

(2) An institution must use the credit assessments of its securitisation positions in a consistent and non-selective manner and, for these purposes, must comply with the following requirements–

(a) an institution must not use an ECAI's credit assessments for its positions in some tranches and another ECAI's credit assessments for its positions in other tranches within the same securitisation that may or may not be rated by the first ECAI;

(b) where a position has two credit assessments by nominated ECAIs, the institution must use the less favourable credit assessment;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(c) where a position has three or more credit assessments by nominated ECAIs, the two most favourable credit assessments must be used. Where the two most favourable assessments are different, the less favourable of the two must be used;

(d) an institution must not actively solicit the withdrawal of less favourable ratings.

(3) Where the exposures underlying a securitisation benefit from full or partial eligible credit protection in accordance with Chapter 4, and the effect of such protection has been reflected in the credit assessment of a securitisation position by a nominated ECAI, the institution must use the risk weight associated with that credit assessment. Where the credit protection referred to in this paragraph is not eligible under Chapter 4, the credit assessment is not recognised and the securitisation position is treated as unrated.

(4) Where a securitisation position benefits from eligible credit protection in accordance with Chapter 4 and the effect of such protection has been reflected in its credit assessment by a nominated ECAI, the institution must treat the securitisation position as if it were unrated and calculate the risk-weighted exposure amounts in accordance with Chapter 4.

270E. [Not used]

CHAPTER 6
COUNTERPARTY CREDIT RISK

Definitions

Determination of the exposure value.

271.(1) An institution must determine the exposure value of derivative instruments listed in Schedule 2 in accordance with this Chapter.

(2) An institution may determine the exposure value of repurchase transactions, securities or commodities lending or borrowing transactions, long settlement transactions and margin lending transactions in accordance with this Chapter instead of making use of Chapter 4.

Definitions.

272. For the purposes of this Chapter and of Title 6 of this Part, the following definitions apply–

CCR related risks

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

"contractual cross product netting agreement" means a bilateral contractual agreement between an institution and a counterparty which creates a single legal obligation (based on netting of covered transactions) covering all bilateral master agreements and transactions belonging to different product categories that are included within the agreement and, for the purposes of this definition, "different product categories" means–

(a) repurchase transactions, securities and commodities lending and borrowing transactions;

(b) margin lending transactions;

(c) the contracts listed in Schedule 2;

"counterparty" for the purposes of Articles 295 to 298 means any legal or natural person that enters into a netting agreement, and has the contractual capacity to do so;

"payment leg" means the payment agreed in an OTC derivative transaction with a linear risk profile which stipulates the exchange of a financial instrument for a payment;

In the case of transactions that stipulate the exchange of payment against payment, those two payment legs must consist of the contractually agreed gross payments, including the notional amount of the transaction.

"rollover risk" means the amount by which EPE is understated when future transactions with a counterparty are expected to be conducted on an ongoing basis;

The additional exposure generated by those future transactions is not included in calculation of EPE.

Distributions

"actual distribution" means a distribution of market values or exposures at a future time period where the distribution is calculated using historic or realised values such as volatilities calculated using past price or rate changes;

"distribution of exposures" means the forecast of the probability distribution of market values that is generated by setting forecast instances of negative net market values equal to zero;

"distribution of market values" means the forecast of the probability distribution of net market values of transactions within a netting set for a future date (the forecasting

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

horizon), given the realised market value of those transactions at the date of the forecast;

"risk-neutral distribution" means a distribution of market values or exposures over a future time period where the distribution is calculated using market implied values such as implied volatilities;

Exposure measures and adjustments

"current exposure" means the larger of zero and the market value of a transaction or portfolio of transactions within a netting set with a counterparty that would be lost upon the default of the counterparty, assuming no recovery on the value of those transactions in insolvency or liquidation;

"effective expected exposure at a specific date" ("Effective EE") means the maximum expected exposure that occurs at that date or any prior date. Alternatively, it may be defined for a specific date as the greater of the expected exposure at that date or the effective expected exposure at any prior date;

"effective expected positive exposure" ("Effective EPE") means the weighted average of effective expected exposure over the first year of a netting set or, if all the contracts within the netting set mature within less than one year, over the time period of the longest maturity contract in the netting set, where the weights are the proportion of the entire time period that an individual expected exposure represents;

"expected exposure" ("EE") means the average of the distribution of exposures at a particular future date before the longest maturity transaction in the netting set matures;

"expected positive exposure" ("EPE") means the weighted average over time of expected exposures, where the weights are the proportion of the entire time period that an individual expected exposure represents;

When calculating the own funds requirement, institutions must take the average over the first year or, if all the contracts within the netting set mature within less than one year, over the time period until the contract with the longest maturity in the netting set has matured.

"peak exposure" means a high percentile of the distribution of exposures at particular future date before the maturity date of the longest transaction in the netting set;

General terms

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

"counterparty credit risk" or "CCR" means the risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flows;

Netting set, hedging sets, and related terms

"cross-product netting" means the inclusion of transactions of different product categories within the same netting set pursuant to the cross-product netting rules set out in this Chapter;

"current market value" or "CMV" means the net market value of all the transactions within a netting set gross of any collateral held or posted where positive and negative market values are netted in computing the CMV;

"effective maturity" under the Internal Model Method for a netting set with maturity greater than one year means the ratio of the sum of expected exposure over the life of the transactions in the netting set discounted at the risk-free rate of return, divided by the sum of expected exposure over one year in the netting set discounted at the risk-free rate;

This effective maturity may be adjusted to reflect rollover risk by replacing expected exposure with effective expected exposure for forecasting horizons under one year;

"hedging set" means a group of transactions within a single netting set for which full or partial offsetting is allowed for determining the potential future exposure under the methods set out in Articles 274 to 281;

"margin agreement" means an agreement or provisions of an agreement under which one counterparty must supply collateral to a second counterparty when an exposure of that second counterparty to the first counterparty exceeds a specified level;

"margin period of risk" means the time period from the most recent exchange of collateral covering a netting set of transactions with a defaulting counterparty until the transactions are closed out and the resulting market risk is re-hedged;

"margin threshold" means the largest amount of an exposure that remains outstanding before one party has the right to call for collateral;

"net independent collateral amount" or "NICA" means the sum of the volatility-adjusted value of net collateral received or posted, as applicable, to the netting set other than variation margin;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

"netting set" means a group of transactions between an institution and a single counterparty that is subject to a legally enforceable bilateral netting arrangement that is recognised under Articles 295 to 298 and Chapter 4;

Each transaction that is not subject to a legally enforceable bilateral netting arrangement which is recognised under Articles 295 to 298 is treated as its own netting set for the purposes of this Chapter.

Under the Internal Model Method set out in Articles 283 to 294, all netting sets with a single counterparty may be treated as a single netting set if negative simulated market values of the individual netting sets are set to 0 in the estimation of expected exposure ("EE");

"one way margin agreement" means a margin agreement under which an institution is required to post variation margin to a counterparty but is not entitled to receive variation margin from that counterparty or vice-versa;

"risk position" means a risk number that is assigned to a transaction under the Standardised Method set out in Article 282 following a predetermined algorithm;

Transaction types

"long settlement transactions" means transactions where a counterparty undertakes to deliver a security, a commodity, or a foreign exchange amount against cash, other financial instruments, or commodities, or vice versa, at a settlement or delivery date specified by contract that is later than the market standard for this particular type of transaction or five business days after the date on which the institution enters into the transaction, whichever is earlier;

"margin lending transactions" means transactions in which an institution extends credit in connection with the purchase, sale, carrying or trading of securities. Margin lending transactions do not include other loans that are secured by collateral in the form of securities.

Methods for calculating the exposure value

Methods for calculating the exposure value

273.(1) Institutions must calculate the exposure value for the contracts listed in Schedule 2 on the basis of one of the methods set out in Articles 274 to 294 in accordance with this Article.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

An institution which does not meet the conditions set out in Article 273A(1) must not use the method set out in Article 281. An institution which does not meet the conditions set out in Article 273A(2) must not use the method set out in Article 282.

Institutions may use in combination the methods set out in Articles 274 to 294 on a permanent basis within a group. A single institution must not use in combination the methods set out in Articles 274 to 294 on a permanent basis.

(2) Where permitted by the GFSC in accordance with Article 283(1) and (2), an institution may determine the exposure value for the following items using the Internal Model Method set out in Article 283 to 294–

(a) the contracts listed in Schedule 2;

(b) repurchase transactions;

(c) securities or commodities lending or borrowing transactions;

(d) margin lending transactions;

(e) long settlement transactions.

(3) When an institution purchases protection through a credit derivative against a non-trading book exposure or against a counterparty risk exposure, it may calculate its own funds requirement for the hedged exposure in accordance with either of the following–

(a) Articles 233 to 236;

(b) in accordance with Article 153(3), or Article 183, where approval has been granted in accordance with Article 143.

The exposure value for CCR for those credit derivatives must be zero, unless an institution applies the approach in Article 299(2)(h)(ii).

(4) Despite paragraph (3), an institution may choose consistently to include for the purposes of calculating own funds requirements for counterparty credit risk all credit derivatives not included in the trading book and purchased as protection against a non-trading book exposure or against a counterparty credit risk exposure where the credit protection is recognised under these Standards.

(5) Where credit default swaps sold by an institution are treated by an institution as credit protection provided by that institution and are subject to own funds requirement for credit risk

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

of the underlying for the full notional amount, their exposure value for the purposes of CCR in the non-trading book must be zero.

(6) Under the methods set out in Articles 274 to 294, the exposure value for a given counterparty must be equal to the sum of the exposure values calculated for each netting set with that counterparty.

By way of derogation from the first sub-paragraph, where one margin agreement applies to multiple netting sets with that counterparty and the institution is using one of the methods set out in Articles 274 to 294 to calculate the exposure value of those netting sets, the exposure value is calculated in accordance with the relevant Articles.

For a given counterparty, the exposure value for a given netting set of OTC derivative instruments listed in Schedule 2 calculated in accordance with this Chapter must be the greater of zero and the difference between the sum of exposure values across all netting sets with the counterparty and the sum of credit valuation adjustments for that counterparty being recognised by the institution as an incurred write-down. The credit valuation adjustments must be calculated without taking into account any offsetting debit value adjustment attributed to the own credit risk of the firm that has been already excluded from own funds in accordance with Article 33(1)(c).

(7) In calculating the exposure value in accordance with the methods set out in Articles 274 to 282, institutions may treat two OTC derivative contracts included in the same netting agreement that are perfectly matching as if they were a single contract with a notional principal equal to zero.

For the purposes of the first sub-paragraph, two OTC derivative contracts are perfectly matching when they meet all the following conditions–

(a) their risk positions are opposite;

(b) their features, with the exception of the trade date, are identical;

(c) their cash flows fully offset each other.

(8) Institutions must determine the exposure value for exposures arising from long settlement transactions by any of the methods set out in Articles 274 to 294, regardless of which method the institution has chosen for treating OTC derivatives and repurchase transactions, securities or commodities lending or borrowing transactions, and margin lending transactions. In calculating the own funds requirements for long settlement transactions, an institution that uses the approach set out in Chapter 3 may assign the risk weights under the approach set out in Chapter 2 on a permanent basis and irrespective of the materiality of those positions.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(9) For the methods set out in Articles 274 to 294, institutions must treat transactions where Specific Wrong-Way risk has been identified in accordance with Article 291(2), (4), (5), and (6).

Conditions for using simplified methods for calculating the exposure value.

273A.(1) An institution may calculate the exposure value of its derivative positions in accordance with the method set out in Article 281 where the size of its on- and off-balance-sheet derivative business is equal to or less than both of the following thresholds on the basis of an assessment carried out on a monthly basis using the data as of the last day of the month–

(a) 10% of the institution's total assets; and

(b) £260 million.

(2) An institution may calculate the exposure value of its derivative positions in accordance with the method set out in Article 282 where the size of its on- and off-balance-sheet derivative business is equal to or less than both of the following thresholds on the basis of an assessment carried out on a monthly basis using the data as of the last day of the month–

(a) 5% of the institution's total assets; and

(b) £88 million.

(3) For the purposes of paragraphs (1) and (2), institutions must calculate the size of their on- and off-balance- sheet derivative business on the basis of data as of the last day of each month in accordance with the following requirements–

(a) derivative positions must be valued at their market values on that given date; where the market value of a position is not available on a given date, institutions must take a fair value for the position on that date; where the market value and fair value of a position are not available on a given date, institutions must take the most recent of the market value or fair value for that position;

(b) the absolute value of long derivative positions must be summed with the absolute value of short derivative positions;

(c) all derivative positions must be included, except credit derivatives that are recognised as internal hedges against non-trading book credit risk exposures.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(4) By way of derogation from paragraph (1) or (2), as applicable, where the derivative business on a consolidated basis does not exceed the thresholds set out in paragraph (1) or (2), as applicable, an institution which is included in the consolidation and which would have to apply the method set out in Articles 274 to 281 because it exceeds those thresholds on an individual basis, may, subject to the approval of the GFSC, instead choose to apply the method that would apply on a consolidated basis.

(5) Institutions must notify the GFSC of the methods set out in Articles 281 and 282 that they use, or cease to use, as applicable, to calculate the exposure value of their derivative positions.

(6) Institutions must not enter into a derivative transaction or buy or sell a derivative instrument for the sole purpose of complying with any of the conditions set out in paragraphs (1) and (2) during the monthly assessment.

Non-compliance with the conditions for using simplified methods for calculating the exposure value of derivatives.

273B.(1) An institution that no longer meets one or more of the conditions set out in Article 273A(1) or (2) must immediately notify the GFSC of that fact.

(2) An institution must cease to calculate the exposure values of its derivative positions in accordance with Articles 281 and 282, as applicable, within six months of one of the following occurring–

(a) the institution does not meet the conditions set out in Article 273A(1)(a) or (2)(a), as applicable, or the conditions set out in Article 273A(1)(b) or (2)(b), as applicable, for three consecutive months;

(b) the institution does not meet the conditions set out in Article 273A(1)(a) or (2)(a), as applicable, or the conditions set out in Article 273A(1)(b) or (2)(b), as applicable, for more than six of the preceding 12 months.

(3) Where an institution has ceased to calculate the exposure values of its derivative positions in accordance with Articles 281 and 282, as applicable, it must only be permitted to resume calculating the exposure value of its derivative positions as set out in Articles 281 and 282 where it demonstrates to the GFSC that all the conditions set out in Article 273A(1) or (2) have been met for an uninterrupted period of one year.

Standardised approach for counterparty credit risk

Exposure value.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

274.(1) An institution may calculate a single exposure value at netting set level for all the transactions covered by a contractual netting agreement where all the following conditions are met–

(a) the netting agreement belongs to one of the types of contractual netting agreements referred to in Article 295;

(b) the netting agreement has been recognised by the GFSC in accordance with Article 296;

(c) the institution has fulfilled the obligations laid down in Article 297 in respect of the netting agreement.

Where any of the conditions set out in the first sub-paragraph are not met, the institution must treat each transaction as if it was its own netting set.

(2) Institutions must calculate the exposure value of a netting set under the standardised approach for counterparty credit risk as follows–

Exposure value = $\alpha \cdot (RC + PFE)$

where–

RC = the replacement cost calculated in accordance with Article 275;

PFE = the potential future exposure calculated in accordance with Article 278; and

$\alpha = 1.4$.

(3) The exposure value of a netting set that is subject to a contractual margin agreement is capped at the exposure value of the same netting set not subject to any form of margin agreement.

(4) Where multiple margin agreements apply to the same netting set, institutions must calculate the replacement cost of the netting set in accordance with Article 275(2) for margined transactions. The potential future exposure of the netting set is calculated in accordance with Article 278 with the modification that AggAddOn must be set equal to the sum of AggAddOn across each sub-netting set, with sub-netting sets constructed as follows–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) all transactions that are unmargined or are subject to a one way margin agreement where the institution is required to post, but not entitled to receive, variation margin, within the netting set form a single sub-netting set;

(b) all margined transactions within the netting set that share the same margin period of risk form a single sub-netting set.

(5) Institutions may set to zero the exposure value of a netting set that satisfies all the following conditions–

(a) the netting set is solely composed of sold options;

(b) the current market value of the netting set is at all times negative;

(c) the premium of all the options included in the netting set has been received upfront by the institution to guarantee the performance of the contracts;

(d) the netting set is not subject to any margin agreement.

(6) In a netting set, institutions must replace a transaction which is a finite linear combination of bought or sold call or put options with all the single options that form that linear combination, taken as an individual transaction, for the purpose of calculating the exposure value of the netting set in accordance with Articles 274 to 280F. Each such combination of options must be treated as an individual transaction in the netting set in which the combination is included for the purpose of calculating the exposure value.

(7) The exposure value of a credit derivative transaction representing a long position in the underlying may be capped to the amount of outstanding unpaid premium provided it is treated as its own netting set that is not subject to a margin agreement.

Replacement cost.

275.(1) Institutions must calculate the replacement cost RC for netting sets that are not subject to a margin agreement, in accordance with the following formula–

$$RC = \max\{CMV - NICA, 0\}$$

For netting sets that are subject to one way margin agreements where the institution is required to post, but not entitled to receive, variation margin, NICA must include VM (as defined in paragraph (2)).

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(2) Institutions must calculate the replacement cost for single netting sets that are subject to a margin agreement in accordance with the following formula–

$$RC = \max\{CMV - VM - NICA, TH + MTA - NICA, 0\}$$

where–

RC = the replacement cost;

VM = the volatility-adjusted value of the net variation margin received or posted, as applicable, to the netting set on a regular basis to mitigate changes in the netting set's CMV;

TH = the margin threshold applicable to the netting set under the margin agreement below which the institution cannot call for collateral; and

MTA = the minimum transfer amount applicable to the netting set under the margin agreement.

(3) Institutions must calculate the replacement cost for multiple netting sets that are subject to the same margin agreement in accordance with the following formula–

$$RC = \max\left\{\sum_i \max\{CMV_i, 0\} - \max\{VM_{MA} + NICA_{MA}, 0\}, 0\right\} + \max\left\{\sum_i \min\{CMV_i, 0\} - \min\{VM_{MA} + NICA_{MA}, 0\}, 0\right\}$$

where–

RC = the replacement cost;

i = the index that denotes the netting sets that are subject to the single margin agreement;

CMVi = the CMV of netting set i;

VM_{MA} = the sum of the volatility-adjusted value of collateral received or posted, as applicable, to multiple netting sets on a regular basis to mitigate changes in their CMV; and

$NICA_{MA}$ = the sum of the volatility-adjusted value of collateral received or posted, as applicable, to multiple netting sets other than VM MA.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

For the purposes of the first sub-paragraph, $NICA_{MA}$ may be calculated at trade level, at netting set level or at the level of all the netting sets to which the margin agreement applies depending on the level at which the margin agreement applies.

Recognition and treatment of collateral.

276.(1) For the purposes of Articles 274 to 280F, institutions must calculate the collateral amounts of VM, VMMA, NICA and NICAMA, by applying all the following requirements–

(a) where all the transactions included in a netting set belong to the trading book, only collateral that is eligible under Articles 197 and 299 must be recognised;

(b) where a netting set contains at least one transaction that belongs to the non-trading book, only collateral that is eligible under Article 197 must be recognised;

(c) collateral received from a counterparty must be recognised with a positive sign and collateral posted to a counterparty must be recognised with a negative sign;

(d) the volatility-adjusted value of any type of collateral received or posted is calculated in accordance with Article 223; for the purposes of that calculation, institutions must not use the method set out in Article 225;

(e) the same collateral item must not be included in both VM and NICA at the same time;

(f) the same collateral item must not be included in both VMMA and NICAMA at the same time;

(g) any collateral posted to the counterparty that is segregated from the assets of that counterparty and, as a result of that segregation, is bankruptcy remote in the event of the default or insolvency of that counterparty is not recognised in the calculation of NICA and NICAMA.

(2) For the calculation of the volatility-adjusted value of collateral posted referred to in paragraph (1)(d), institutions must replace the formula set out in Article 223(2) with the following formula–

$$CVA = C \cdot (1 + HC + Hfx)$$

where–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

CVA = the volatility-adjusted value of collateral posted;

C = the collateral; and

HC and Hfx are defined in accordance with Article 223(2).

(3) For the purposes of paragraph (1)(d), institutions must set the liquidation period relevant for the calculation of the volatility-adjusted value of any collateral received or posted in accordance with one of the following time horizons–

(a) the longest remaining maturity of transactions in the netting set, capped at one year for the netting sets referred to in Article 275(1);

(b) the margin period of risk determined in accordance with Article 279C(1)(b) for the netting sets referred to in Article 275(2) and (3).

Mapping of transactions to risk categories.

277.(1) Institutions must map each transaction of a netting set to one of the following risk categories to determine the potential future exposure of the netting set referred to in Article 278–

(a) interest rate risk;

(b) foreign exchange risk;

(c) credit risk;

(d) equity risk;

(e) commodity risk;

(f) other risks.

(2) Institutions must conduct the mapping referred to in paragraph (1) on the basis of the primary risk driver of a derivative transaction. The primary risk driver must be the only material risk driver of a derivative transaction.

(3) By way of derogation from paragraph (2), institutions must map derivative transactions that have more than one material risk driver to more than one risk category. Where all the material risk drivers of one of those transactions belong to the same risk category, institutions must only be required to map that transaction once to that risk category on the basis of the

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

most material of those risk drivers. Where the material risk drivers of one of those transactions belong to different risk categories, institutions must map that transaction once to each risk category for which the transaction has at least one material risk driver, on the basis of the most material of the risk drivers in that risk category.

(4) Despite paragraphs (1), (2) and (3), when mapping transactions to the risk categories listed in paragraph (1), institutions must apply the following requirements–

(a) where the primary risk driver of a transaction, or the most material risk driver in a given risk category for transactions referred to in paragraph (3), is an inflation variable, institutions must map the transaction to the interest rate risk category;

(b) where the primary risk driver of a transaction, or the most material risk driver in a given risk category for transactions referred to in paragraph (3), is a climatic conditions variable, institutions must map the transaction to the commodity risk category.

(5) [Not used]

Hedging sets.

277A.(1) Institutions must establish the relevant hedging sets for each risk category of a netting set and assign each transaction to those hedging sets as follows–

(a) transactions mapped to the interest rate risk category are assigned to the same hedging set only where their primary risk driver, or the most material risk driver in the given risk category for transactions referred to in Article 277(3), is denominated in the same currency;

(b) transactions mapped to the foreign exchange risk category are assigned to the same hedging set only where their primary risk driver, or the most material risk driver in the given risk category for transactions referred to in Article 277(3), is based on the same currency pair;

(c) all the transactions mapped to the credit risk category are assigned to the same hedging set;

(d) all the transactions mapped to the equity risk category are assigned to the same hedging set;

(e) transactions mapped to the commodity risk category are assigned to one of the following hedging sets on the basis of the nature of their primary risk driver or the

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

most material risk driver in the given risk category for transactions referred to in Article 277(3)–

(i) energy;

(ii) metals;

(iii) agricultural goods;

(iv) other commodities;

(v) climatic conditions;

(f) transactions mapped to the other risks category are assigned to the same hedging set only where their primary risk driver, or the most material risk driver in the given risk category for transactions referred to in Article 277(3), is identical.

For the purposes of sub-paragraph (a), transactions mapped to the interest rate risk category that have an inflation variable as the primary risk driver are assigned to separate hedging sets, other than the hedging sets established for transactions mapped to the interest rate risk category that do not have an inflation variable as the primary risk driver. Those transactions are assigned to the same hedging set only where their primary risk driver, or the most material risk driver in the given risk category for transactions referred to in Article 277(3), is denominated in the same currency.

(2) By way of derogation from paragraph (1), institutions must establish separate individual hedging sets in each risk category for the following transactions–

(a) transactions for which the primary risk driver, or the most material risk driver in the given risk category for transactions referred to in Article 277(3), is either the market implied volatility or the realised volatility of a risk driver or the correlation between two risk drivers;

(b) transactions for which the primary risk driver, or the most material risk driver in the given risk category for transactions referred to in Article 277(3), is the difference between two risk drivers mapped to the same risk category or transactions that consist of two payment legs denominated in the same currency and for which a risk driver from the same risk category of the primary risk driver is contained in the other payment leg than the one containing the primary risk driver.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

For the purposes of sub-paragraph (a), institutions must assign transactions to the same hedging set of the relevant risk category only where their primary risk driver, or the most material risk driver in the given risk category for transactions referred to in Article 277(3), is identical.

For the purposes of sub-paragraph (b), institutions must assign transactions to the same hedging set of the relevant risk category only where the pair of risk drivers in those transactions as referred to in that sub-paragraph is identical and the two risk drivers contained in this pair are positively correlated. Otherwise, institutions must assign transactions referred to in sub-paragraph (b) to one of the hedging sets established in accordance with paragraph (1), on the basis of only one of the two risk drivers referred to in sub-paragraph (b).

(3) Institutions must make available upon request by the GFSC the number of hedging sets established in accordance with paragraph (2) for each risk category, with the primary risk driver, or the most material risk driver in the given risk category for transactions referred to in Article 277(3), or the pair of risk drivers of each of those hedging sets and with the number of transactions in each of those hedging sets.

Potential future exposure.

278.(1) Institutions must calculate the potential future exposure of a netting set as follows–

$$\text{PFE} = \text{multiplier} \cdot \sum_{a} \text{AddOn}^{(a)}$$

where–

PFE = the potential future exposure;

a = the index that denotes the risk categories included in the calculation of the potential future exposure of the netting set;

AddOn(a) = the add-on for risk category a calculated in accordance with Articles 280A to 280F, as applicable; and

multiplier = the multiplication factor calculated in accordance with the formula referred to in paragraph (3).

For the purpose of this calculation, institutions must include the add-on of a given risk category in the calculation of the potential future exposure of a netting set where at least one transaction of the netting set has been mapped to that risk category.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(2) The potential future exposure of multiple netting sets that are subject to one margin agreement, as referred in Article 275(3), are calculated as the sum of the potential future exposures of all the individual netting sets as if they were not subject to any form of a margin agreement.

(3) For the purposes of paragraph (1), the multiplier is calculated as follows–

$$\text{multiplier} = \begin{cases} 1 \text{ if } z \geq 0 \\ \min\left\{1, \text{Floor}_m + (1 - \text{Floor}_m) \cdot \exp\left(\frac{z}{y}\right)\right\} \text{ if } z < 0 \end{cases}$$

where–

Floorm = 5%;

y = 2 · (1 – Floorm) · Σa AddOn(a);

z =CMV – NICA for the netting sets referred to in Article 275(1);

CMV – VM – NICA for the netting sets referred to in Article 275(2);

CMVi – NICAi for the netting sets referred to in Article 275(3);

NICAi = the net independent collateral amount calculated only for transactions that are included in netting set i. NICAi must be calculated at trade level or at netting set level depending on the margin agreement.

Calculation of the risk position.

279. For the purpose of calculating the risk category add-ons referred to in Articles 280A to 280f, institutions must calculate the risk position of each transaction of a netting set as follows–

Risk Position = δ • AdjNot • MF

where–

δ = the supervisory delta of the transaction calculated in accordance with the formula laid down in Article 279A;

AdjNot = the adjusted notional amount of the transaction calculated in accordance with Article 279B; and

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

MF = the maturity factor of the transaction calculated in accordance with the formula laid down in Article 279C.

Supervisory delta.

279A.(1) Institutions must calculate the supervisory delta as follows–

(a) for call and put options that entitle the option buyer to purchase or sell an underlying instrument at a positive price on a single or multiple dates in the future, except where those options are mapped to the interest rate risk category, institutions must use the following formula–

$$\delta = sign \cdot N\left(type \cdot \frac{(\ln((P+\lambda)/(K+\lambda)) + 0.5 \cdot \sigma^2 \cdot T}{\sigma \cdot \sqrt{T}}\right)$$

where–

δ = the supervisory delta;

sign = – 1 where the transaction is a sold call option or a bought put option;

sign = + 1 where the transaction is a bought call option or sold put option;

type = – 1 where the transaction is a put option;

type = + 1 where the transaction is a call option;

N(x) = the cumulative distribution function for a standard normal random variable meaning the probability that a normal random variable with mean zero and variance of one is less than or equal to x;

P = the spot or forward price of the underlying instrument of the option; for options the cash flows of which depend on an average value of the price of the underlying instrument, P must be equal to the average value at the calculation date;

K = the strike price of the option;

T = the expiry date of the option; for options which can be exercised at one future date only, the expiry date is equal to that date; for options which can be exercised at multiple future dates, the expiry date is equal to the latest of those dates; the expiry date must be expressed in years using the relevant business day convention;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

σ = the supervisory volatility of the option determined in accordance with Table 1 on the basis of the risk category of the transaction and the nature of the underlying instrument of the option; and

λ = the presumed lowest possible extent to which prices of the underlying instrument of the option can become negative. The same parameter must be used consistently for all options in the same underlying instrument. For options on interest rates, the same parameter must be used consistently for all options in the same currency.

Table 1

Risk category	Underlying instrument	Supervisory volatility
Foreign exchange	All	15%
Credit	Single-name instrument	100%
	Multiple-names instrument	80%
Equity	Single-name instrument	120%
	Multiple-names instrument	75%
Commodity	Electricity	150 %
	Other commodities	70%
Others	All	150%

Institutions using the forward price of the underlying instrument of an option must ensure that–

(i) the forward price is consistent with the characteristics of the option;

(ii) the forward price is calculated using a relevant interest rate prevailing at the reporting date;

(iii) the forward price integrates the expected cash flows of the underlying instrument before the expiry of the option;

(b) for tranches of a synthetic securitisation and a nth-to-default credit derivative, institutions must use the following formula–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

$$\delta = \text{sign} \cdot \frac{15}{(1 + 14 \cdot A) \cdot (1 + 14 \cdot D)}$$

where–

sign = +1 where credit protection has been obtained through the transaction;

sign = -1 where credit protection has been provided through the transaction;

A = the attachment point of the tranche; for a nth-to-default credit derivative transaction based on reference entities k, A = (n – 1)/k; and

D = the detachment point of the tranche; for a nth-to- default credit derivative transaction based on reference entities k, D = n/k;

(c) for transactions not referred to in point (a) or (b), institutions must use the following supervisory delta–

$$\delta = \begin{cases} +1 \text{ if the transaction is a long position in the primary risk driver or in} \\ \text{the most material risk driver in the given risk category} \\ -1 \text{ if the transaction is a short position in the primary risk driver or in} \\ \text{the most material risk driver in the given risk category} \end{cases}$$

(2) For the purposes of Articles 274 to 280F, a long position in the primary risk driver or in the most material risk driver in the given risk category for transactions referred to in Article 277(3) means that the market value of the transaction increases when the value of that risk driver increases and a short position in the primary risk driver or in the most material risk driver in the given risk category for transactions referred to in Article 277(3) means that the market value of the transaction decreases when the value of that risk driver increases.

(3) [Not used]

Adjusted notional amount.

279B.(1) Institutions must calculate the adjusted notional amount as follows–

(a) for transactions mapped to the interest rate risk category or the credit risk category, institutions must calculate the adjusted notional amount as the product of the notional amount of the derivative contract and the supervisory duration factor, which must be calculated as follows–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

$$\text{supervisory duration factor} = \frac{\exp(-R \cdot S) - \exp(-R \cdot E)}{R}$$

where–

R = the supervisory discount rate; R = 5%;

S = the period between the start date of a transaction and the reporting date, which must be expressed in years using business days; and

E = the period between the end date of a transaction and the reporting date, which must be expressed in years using business days.

The start date of a transaction is the earliest date at which at least a contractual payment under the transaction, to or from the institution, is either fixed or exchanged, other than payments related to the exchange of collateral in a margin agreement. Where the transaction has already been fixing or making payments at the reporting date, the start date of a transaction must be equal to 0.

Where a transaction involves one or more contractual future dates on which the institution or the counterparty may decide to terminate the transaction prior to its contractual maturity, the start date of a transaction must be equal to the earliest of the following–

(i) the date or the earliest of the multiple future dates at which the institution or the counterparty may decide to terminate the transaction earlier than its contractual maturity;

(ii) the date at which a transaction starts fixing or making payments, other than payments related to the exchange of collateral in a margin agreement.

Where a transaction has a financial instrument as the underlying instrument that may give rise to contractual obligations additional to those of the transaction, the start date of a transaction is determined on the basis of the earliest date at which the underlying instrument starts fixing or making payments.

The end date of a transaction is the latest date at which a contractual payment under the transaction, to or from the institution, is or may be exchanged.

Where a transaction has a financial instrument as an underlying instrument that may give rise to contractual obligations additional to those of the transaction, the

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

end date of a transaction is determined on the basis of the last contractual payment of the underlying instrument of the transaction.

Where a transaction is structured to settle an outstanding exposure following specified payment dates and where the terms are reset so that the market value of the transaction is zero on those specified dates, the settlement of the outstanding exposure at those specified dates is considered a contractual payment under the same transaction;

(b) for transactions mapped to the foreign exchange risk category, institutions must calculate the adjusted notional amount as follows–

(i) where the transaction consists of one payment leg, the adjusted notional amount must be the notional amount of the derivative contract;

(ii) where the transaction consists of two payment legs and the notional amount of one payment leg is denominated in the institution's reporting currency, the adjusted notional amount must be the notional amount of the other payment leg;

(iii) where the transaction consists of two payment legs and the notional amount of each payment leg is denominated in a currency other than the institution's reporting currency, the adjusted notional amount must be the largest of the notional amounts of the two payment legs after those amounts have been converted into the institution's reporting currency at the prevailing spot exchange rate;

(c) for transactions mapped to the equity risk category or commodity risk category, institutions must calculate the adjusted notional amount as the product of the market price of one unit of the underlying instrument of the transaction and the number of units in the underlying instrument referenced by the transaction;

where a transaction mapped to the equity risk category or commodity risk category is contractually expressed as a notional amount, institutions must use the notional amount of the transaction rather than the number of units in the underlying instrument as the adjusted notional amount;

(d) for transactions mapped to the other risks category, institutions must calculate the adjusted notional amount on the basis of the most appropriate method among the methods set out in sub-paragraphs (a), (b) and (c), depending on the nature and characteristics of the underlying instrument of the transaction.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(2) Institutions must determine the notional amount or number of units of the underlying instrument for the purpose of calculating the adjusted notional amount of a transaction referred to in paragraph (1) as follows–

(a) where the notional amount or the number of units of the underlying instrument of a transaction is not fixed until its contractual maturity–

(i) for deterministic notional amounts and numbers of units of the underlying instrument, the notional amount must be the weighted average of all the deterministic values of notional amounts or number of units of the underlying instrument, as applicable, until the contractual maturity of the transaction, where the weights are the proportion of the time period during which each value of notional amount applies;

(ii) for stochastic notional amounts and numbers of units of the underlying instrument, the notional amount must be the amount determined by fixing current market values within the formula for calculating the future market values;

(b) for contracts with multiple exchanges of the notional amount, the notional amount is multiplied by the number of remaining payments still to be made in accordance with the contracts;

(c) for contracts that provide for a multiplication of the cash-flow payments or a multiplication of the underlying of the derivative contract, the notional amount is adjusted by an institution to take into account the effects of the multiplication on the risk structure of those contracts.

(3) Institutions must convert the adjusted notional amount of a transaction into their reporting currency at the prevailing spot exchange rate where the adjusted notional amount is calculated under this Article from a contractual notional amount or a market price of the number of units of the underlying instrument denominated in another currency.

Maturity Factor.

279C.(1) Institutions must calculate the maturity factor as follows–

(a) for transactions included in the netting sets referred to in Article 275(1), institutions must use the following formula–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

$$MF = \sqrt{\min\{\max\{M,\ 10/OneBusinessYear\},\ 1\}}$$

where–

MF = the maturity factor;

M = the remaining maturity of the transaction which is equal to the period of time needed for the termination of all contractual obligations of the transaction; for that purpose, any optionality of a derivative contract is considered to be a contractual obligation; the remaining maturity must be expressed in years using business days;

where a transaction has another derivative contract as underlying instrument that may give rise to additional contractual obligations beyond the contractual obligations of the transaction, the remaining maturity of the transaction must be equal to the period of time needed for the termination of all contractual obligations of the underlying instrument;

where a transaction is structured to settle outstanding exposure following specified payment dates and where the terms are reset so that the market value of the transaction is zero on those specified dates, the remaining maturity of the transaction must be equal to the time until the next reset date; and

(b) for transactions included in the netting sets referred to in Article 275(2) and (3), the maturity factor is defined as–

$$MF = \frac{3}{2}\sqrt{\frac{MPOR}{OneBusinessYear}}$$

where–

MF = the maturity factor;

MPOR = the margin period of risk of the netting set determined in accordance with Article 285(2) to (5); and

When determining the margin period of risk for transactions between a client and a clearing member, an institution acting either as the client or as the clearing member must replace the minimum period set out in Article 285(2)(b) with five business days.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(2) For the purposes of paragraph (1), the remaining maturity must be equal to the period of time until the next reset date for transactions that are structured to settle outstanding exposure following specified payment dates and where the terms are reset in such a way that the market value of the contract must be zero on those specified payment dates.

Hedging set supervisory factor coefficient.

280. For the purpose of calculating the add-on of a hedging set as referred to in Articles 280A to 280F, the hedging set supervisory factor coefficient (ϵ) must be the following–

ϵ = 1 for the hedging sets established in accordance with Article 277A(1);

5 for the hedging sets established in accordance with Article 277A(2)(a); and

0.5 for the hedging sets established in accordance with Article 277A(2)(b).

Interest rate risk category add-on.

280A.(1) For the purposes of Article 278, institutions must calculate the interest rate risk category add-on for a given netting set as follows–

$$AddOn^{IR} = \sum_{j} AddOn_j^{IR}$$

where–

AddOnIR = the interest rate risk category add-on;

j = the index that denotes all the interest rate risk hedging sets established in accordance with Article 277A(1)(a) and with Article 277A(2) for the netting set; and

AddOnjIR = the interest rate risk category add-on for hedging set j calculated in accordance with paragraph (2).

(2) Institutions must calculate the interest rate risk category add-on for hedging set j as follows–

$$AddOn_j^{IR} = \epsilon_j \cdot SF^{IR} \cdot EffNot_j^{IR}$$

where–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

єj = the hedging set supervisory factor coefficient of hedging set j determined in accordance with the applicable value specified in Article 280;

SFIR = the supervisory factor for the interest rate risk category with a value equal to 0.5%; and

EffNotjIR = the effective notional amount of hedging set j calculated in accordance with paragraph (3).

(3) For the purpose of calculating the effective notional amount of hedging set j, institutions must first map each transaction of the hedging set to the appropriate bucket in Table 2. They must do so on the basis of the end date of each transaction as determined under Article 279B(1)(a)–

Table 2

Bucket	End date (in years)
1	> 0 and <= 1
2	> 1 and <= 5
3	> 5

Institutions must then calculate the effective notional amount of hedging set j in accordance with the following formula–

$$\text{EffNot}_j^{IR} = \sqrt{\left[(D_{j,1})^2 + (D_{j,2})^2 + 1{,}4 \cdot D_{j,1} \cdot D_{j,2} + 1{,}4 \cdot D_{j,2} \cdot D_{j,3} + 0{,}6 \cdot D_{j,1} \cdot D_{j,3}\right]}$$

where–

EffNotjIR = the effective notional amount of hedging set j; and

D j,k = the effective notional amount of bucket k of hedging set j calculated as follows–

$$D_{j,k} = \sum_{l \in \text{Bucket } k} \text{RiskPosition}_l$$

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

where–

l = the index that denotes the risk position.

Foreign exchange risk category add-on.

280B.(1) For the purposes of Article 278, institutions must calculate the foreign exchange risk category add-on for a given netting set as follows–

$$\text{AddOn}^{FX} = \sum_{j} \text{AddOn}_j^{FX}$$

where–

AddOnFX = the foreign exchange risk category add on;

j = the index that denotes the foreign exchange risk hedging sets established in accordance with Article 277A(1)(b) of and with Article 277A(2) for the netting set; and

AddOnjFX = the foreign exchange risk category add-on for hedging set j calculated in accordance with paragraph (2).

(2) Institutions must calculate the foreign exchange risk category add-on for hedging set j as follows–

$$\text{AddOn}_j^{FX} = \epsilon_j \cdot SF^{FX} \cdot \left|\text{EffNot}_j^{FX}\right|$$

where–

єj = the hedging set supervisory factor coefficient of hedging set j determined in accordance with Article 280;

SFFX = the supervisory factor for the foreign exchange risk category with a value equal to 4%; and

EffNotjFX = the effective notional amount of hedging set j calculated as follows–

$$\text{EffNot}_j^{FX} = \sum_{l \in \text{Hedging set } j} \text{RiskPosition}_l$$

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

where–

l = the index that denotes the risk position.

Credit risk category add-on.

280C.(1) For the purposes of paragraph (2), institutions must establish the relevant credit reference entities of the netting set in accordance with the following–

(a) there must be one credit reference entity for each issuer of a reference debt instrument that underlies a single-name transaction allocated to the credit risk category; single-name transactions must be assigned to the same credit reference entity only where the underlying reference debt instrument of those transactions is issued by the same issuer;

(b) there must be one credit reference entity for each group of reference debt instruments or single-name credit derivatives that underlie a multi-name transaction allocated to the credit risk category; multi-names transactions must be assigned to the same credit reference entity only where the group of underlying reference debt instruments or single-name credit derivatives of those transactions have the same constituents.

(2) For the purposes of Article 278, institutions must calculate the credit risk category add-on for a given netting set as follows–

$$AddOn^{Credit} = \sum_j AddOn_j^{Credit}$$

where–

AddOnCredit = credit risk category add-on;

j = the index that denotes all the credit risk hedging sets established in accordance with Article 277A(1)(c) and with Article 277A(2) for the netting set; and

AddOnjCredit = the credit risk category add-on for hedging set j calculated in accordance with paragraph (3).

(3) Institutions must calculate the credit risk category add-on for hedging set j as follows–

where–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

AddOnjCredit = the credit risk category add-on for hedging set j;

єj = the hedging set supervisory factor coefficient of hedging set j determined in accordance with Article 280;

k = the index that denotes the credit reference entities of the netting set established in accordance with paragraph (1);

ρkCredit = the correlation factor of the credit reference entity k; where the credit reference entity k has been established in accordance paragraph (1)(a), ρkCredit = 50%, where the credit reference entity k has been established in accordance with paragraph (1)(a), ρkCredit = 80%; and

AddOn(Entityk) = the add-on for the credit reference entity k determined in accordance with paragraph (4).

(4) Institutions must calculate the add-on for the credit reference entity k as follows–

AddOn(Entityk) = EffNotkCredit

where–

EffNotkCredit = the effective notional amount of the credit reference entity k calculated as follows–

$$EffNot_{k}^{Credit} = \sum_{l \in \text{Credit reference entity } k} SF_{k,l}^{Credit} \cdot RiskPosition_{l}$$

where–

l = the index that denotes the risk position; and

SFk,lCredit = the supervisory factor applicable to the credit reference entity k calculated in accordance with paragraph (5).

(5) Institutions must calculate the supervisory factor applicable to the credit reference entity k as follows–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) for the credit reference entity k established in accordance with paragraph (1)(a), SFk,lCredit must be mapped to one of the six supervisory factors set out in Table 3 of this paragraph on the basis of an external credit assessment by a nominated ECAI of the corresponding individual issuer; for an individual issuer for which a credit assessment by a nominated ECAI is not available–

(i) an institution using the approach referred to in Chapter 3 must map the internal rating of the individual issuer to one of the external credit assessments;

(ii) an institution using the approach referred to in Chapter 2 must assign SFk,lCredit = 0.54% to that credit reference entity; however, where an institution applies Article 128 to risk weight counterparty credit risk exposures to that individual issuer, SFk,lCredit = 1.6% must be assigned to that credit reference entity;

(b) for the credit reference entity k established in accordance with paragraph (1)(b)–

(i) where a risk position l assigned to the credit reference entity k is a credit index listed on a recognised exchange, SFk,lCredit must be mapped to one of the two supervisory factors set out in Table 4 of this paragraph on the basis of the credit quality of the majority of its individual constituents;

(ii) where a risk position l assigned to the credit reference entity k is not referred to in paragraph (i), SFk,lCredit must be the weighted average of the supervisory factors mapped to each constituent in accordance with the method set out in sub-paragraph (a), where the weights are defined by the proportion of notional of the constituents in that position.

Table 3

Credit quality step	Supervisory factor for single-name transactions
1	0.38%
2	0.42%
3	0.54%
4	1.06%
5	1.60%
6	6.00%

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Table 4

Dominant credit quality	Supervisory factor for quoted indices
Investment grade	0.38%
Non-investment grade	1.06%

Equity risk category add-on.

280D.(1) For the purposes of paragraph (2), institutions must establish the relevant equity reference entities of the netting set in accordance with the following–

(a) there must be one equity reference entity for each issuer of a reference equity instrument that underlies a single-name transaction allocated to the equity risk category; single-name transactions must be assigned to the same equity reference entity only where the underlying reference equity instrument of those transactions is issued by the same issuer;

(b) there must be one equity reference entity for each group of reference equity instruments or single-name equity derivatives that underlie a multi-name transaction allocated to the equity risk category; multi-names transactions must be assigned to the same equity reference entity only where the group of underlying reference equity instruments or single-name equity derivatives of those transactions, as applicable, has the same constituents.

(2) For the purposes of Article 278, institutions must calculate the equity risk category add-on for a given netting set as follows–

$$\mathrm{AddOn}^{\mathrm{Equity}} = \sum_{j} \mathrm{AddOn}_{j}^{\mathrm{Equity}}$$

where–

AddOnEquity = the equity risk category add-on;

j = the index that denotes all the equity risk hedging sets established in accordance with Articles 277A(1)(d) and 277A(2) for the netting set; and

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

AddOnjEquity = the equity risk category add-on for hedging set j calculated in accordance with paragraph (3).

(3) Institutions must calculate the equity risk category add-on for hedging set j as follows–

$$AddOn_j^{Equity} = \epsilon_j \sqrt{\left(\sum_k \rho_k^{Equity} \cdot AddOn(Entity_k)\right)^2 + \sum_k 1 - \left(\left(\rho_k^{Equity}\right)^2\right) \cdot \left(AddOn(Entity_k)\right)^2}$$

where–

AddOnjEquity = the equity risk category add-on for hedging set j;

ϵj = the hedging set supervisory factor coefficient of hedging set j determined in accordance with Article 280;

k = the index that denotes the equity reference entities of the netting set established in accordance with paragraph (1);

ρkEquity = the correlation factor of the equity reference entity k; where the equity reference entity k has been established in accordance with paragraph (1)(a), that factor = 50% and where it has been established in accordance with paragraph (1)(b), that factor = 80%; and

AddOn(Entityk) = the add-on for the equity reference entity k determined in accordance with paragraph (4).

(4) Institutions must calculate the add-on for the equity reference entity k as follows–

$$AddOn(Entity_k) = SF_k^{Equity} \cdot EffNot_k^{Equity}$$

where–

AddOn(Entityk) = the add-on for the equity reference entity k;

SFkEquity = the supervisory factor applicable to the equity reference entity k; where the equity reference entity k has been established in accordance with paragraph (1)(a), that factor = 32% and where it has been established in accordance with of paragraph (1)(b), that factor = 20%; and

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

EffNotkEquity = the effective notional amount of the equity reference entity k calculated as follows–

$$\text{EffNot}_k^{\text{Equity}} = \sum_{l \in \text{Equity reference entity } k} \text{RiskPosition}_l$$

where l = the index that denotes the risk position.

Commodity risk category add-on.

280E.(1) For the purposes of Article 278, institutions must calculate the commodity risk category add-on for a given netting set as follows–

$$\text{AddOn}^{\text{Com}} = \sum_j \text{AddOn}_j^{\text{Com}}$$

where–

AddOnCom = the commodity risk category add-on;

j = the index that denotes the commodity hedging sets established in accordance with Articles 277A(1)(e) and 277A(2) for the netting set; and

AddOnjCom = the commodity risk category add-on for hedging set j calculated in accordance with paragraph (4).

(2) For the purpose of calculating the add-on for a commodity hedging set of a given netting set in accordance with paragraph (3), institutions must establish the relevant commodity reference types of each hedging set. Commodity derivative transactions are assigned to the same commodity reference type only where the underlying commodity instrument of those transactions has the same nature, irrespective of the delivery location and quality of the commodity instrument.

(3) Institutions must calculate the commodity risk category add-on for hedging set j as follows–

$$\text{AddOn}_j^{\text{Com}} = \epsilon_j \sqrt{\left(\rho^{\text{Com}} \cdot \sum_k \text{AddOn}(\text{Type}_k^j)\right)^2 + (1 - (\rho^{\text{Com}})^2) \cdot \sum_k \text{AddOn}(\text{Type}_k^j))^2}$$

where–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

AddOnjCom = the commodity risk category add-on for hedging set j;

Єj = the hedging set supervisory factor coefficient of hedging set j determined in accordance with Article 280;

ρCom = the correlation factor of the commodity risk category with a value equal to 40%;

k = the index that denotes the commodity reference types of the netting set established in accordance with paragraph (2); and

AddOn(Typejk) = the add-on for the commodity reference type k calculated in accordance with paragraph (4).

(4) Institutions must calculate the add-on for the commodity reference type k as follows–

$$AddOn(Type^{j}_{k}) = SF^{Com}_{k} \cdot EffNot^{Com}_{k}$$

where–

AddOn(Typejk) = the add-on for the commodity reference type k;

SFkCom = the supervisory factor applicable to the commodity reference type k; where the commodity reference type k corresponds to transactions allocated to the hedging set referred to Article 277A(1)(e)(i), excluding transactions concerning electricity, that factor = 18% and for transactions concerning electricity, that factor = 40%; and

EffNotkCom = the effective notional amount of the commodity reference type k calculated as follows–

$$EffNot^{Com}_{k} = \sum_{l \in \text{Commodity reference type k}} RiskPosition_{l}$$

where l = the index that denotes the risk position.

Other risks category add-on.

280F.(1) For the purposes of Article 278, institutions must calculate the other risks category add-on for a given netting set as follows–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

$$\text{AddOn}^{\text{Other}} = \sum_{j} \text{AddOn}_{j}^{\text{Other}}$$

where–

AddOnOther = the other risks category add-on;

Єj = the index that denotes the other risk hedging sets established in accordance with Articles 277A(1)(f) and 277a(2) for the netting set; and

AddOnjOther = the other risks category add-on for hedging set j calculated in accordance with paragraph (2).

(2) Institutions must calculate the other risks category add-on for hedging set j as follows–

$$\text{AddOn}_{j}^{\text{Other}} = \epsilon_{j} \cdot \text{SF}^{\text{Other}} \cdot \left|\text{EffNot}_{j}^{\text{Other}}\right|$$

where–

AddOnjOther = the other risks category add-on for hedging set j;

Єj = the hedging set supervisory factor coefficient of hedging set j determined in accordance with Article 280;

SFOther = the supervisory factor for the other risk category with a value equal to 8%; and

EffNotjOther = the effective notional amount of hedging set j calculated as follows–

$$\text{EffNot}_{j}^{\text{Other}} = \sum_{l \in \text{Hedging set } j} \text{RiskPosition}_{l}$$

where l = the index that denotes the risk position.

Simplified standardised approach for counterparty credit risk

Calculation of the exposure value.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

281.(1) Institutions must calculate a single exposure value at netting set level in accordance with Articles 274 to 280F, subject to paragraph (2).

(2) The exposure value of a netting set must be calculated in accordance with the following requirements–

(a) institutions must not apply the treatment referred to in Article 274(6);

(b) by way of derogation from Article 275(1), for netting sets that are not referred to in Article 275(2), institutions must calculate the replacement cost in accordance with the following formula–

$$RC = \max\{CMV, 0\}$$

where–

RC = the replacement cost; and

CMV = the current market value.

(c) by way of derogation from Article 275(2), for netting sets of transactions– that are traded on a recognised exchange; that are centrally cleared by a central counterparty authorised in accordance with Article 14 of EMIR or recognised in accordance with Article 25 of that Regulation; or for which collateral is exchanged bilaterally with the counterparty in accordance with Article 11 of EMIR, institutions must calculate the replacement cost in accordance with the following formula–

$$RC = TH + MTA$$

where–

RC = the replacement cost;

TH = the margin threshold applicable to the netting set under the margin agreement below which the institution cannot call for collateral; and

MTA = the minimum transfer amount applicable to the netting set under the margin agreement;

(d) by way of derogation from Article 275(3), for multiple netting sets that are subject to a margin agreement, institutions must calculate the replacement cost as the sum

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

of the replacement cost of each individual netting set, calculated in accordance with paragraph (1) as if they were not margined;

(e) all hedging sets must be established in accordance with Article 277A(1);

(f) institutions must set to 1 the multiplier in the formula that is used to calculate the potential future exposure in Article 278(1), as follows–

$$PFE = \sum_{a} AddOn^{(a)}$$

where–

PFE = the potential future exposure; and

AddOn(a) = the add-on for risk category a;

(g) by way of derogation from Article 279A(1), for all transactions, institutions must calculate the supervisory delta as follows

$$\delta = \begin{cases} +1 \text{ where the transaction is a long position in the primary risk driver} \\ -1 \text{ where the transaction is a short position in the primary risk driver} \end{cases}$$

where–

δ = the supervisory data;

(h) the formula referred to in Article 279B(1)(a) that is used to compute the supervisory duration factor must read as follows–

supervisory duration factor = E – S

where–

E = the period between the end date of a transaction and the calculation date; and

S = the period between the start date of a transaction and the calculation date;

(i) the maturity factor referred to in Article 279C(1) is calculated as follows–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(i) for transactions included in netting sets referred to in Article 275(1), MF = 1;

(ii) for transactions included in netting sets referred to in Article 275(2) and (3), MF = 0.42;

(j) the formula referred to in Article 280A(3) that is used to calculate the effective notional amount of hedging set j must read as follows–

$$EffNot_j^{IR} = |D_{j,1}| + |D_{j,2}| + |D_{j,3}|$$

where–

EffNotjIR = the effective notional amount of hedging set j; and

Dj,k = the effective notional amount of bucket k of hedging set j;

(k) the formula referred to in Article 280C(3) that is used to calculate the credit risk category add-on for hedging set j must read as follows–

$$AddOn_j^{Credit} = \sum_k |AddOn(Entity_k)|$$

where–

AddOnjCredit = the credit risk category add-on for hedging set j; and

AddOn(Entityk) = the add-on for the credit reference entity k;

(l) the formula referred to in Article 280D(3) that is used to calculate the equity risk category add-on for hedging set j must read as follows–

$$AddOn_j^{Com} = \sum_k |AddOn(Type_k^j)|$$

where–

AddOnjCom = the commodity risk category add-on for hedging set j; and

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

AddOn(Typejk) = the add-on for the commodity reference type k.

Original exposure method

Calculation of the exposure value.

282.(1) Institutions may calculate a single exposure value for all the transactions within a contractual netting agreement where all the conditions set out in Article 274(1) are met. Otherwise, institutions must calculate an exposure value separately for each transaction, which is treated as its own netting set.

(2) The exposure value of a netting set or a transaction must be the product of 1.4 times the sum of the current replacement cost and the potential future exposure.

(3) The current replacement cost referred to in paragraph (2) is calculated as follows–

(a) for netting sets of transactions– that are traded on a recognised exchange; centrally cleared by a central counterparty authorised in accordance with Article 14 of Regulation (EU) No 648/2012 or recognised in accordance with Article 25 of that Regulation; or for which collateral is exchanged bilaterally with the counterparty in accordance with Article 11 of Regulation (EU) No 648/2012, institutions must use the following formula–

$$RC = TH + MTA$$

where–

RC = the replacement cost;

TH = the margin threshold applicable to the netting set under the margin agreement below which the institution cannot call for collateral; and

MTA = the minimum transfer amount applicable to the netting set under the margin agreement;

(b) for all other netting sets or individual transactions, institutions must use the following formula–

$$RC = \max\{CMV, 0\}$$

where–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

RC = the replacement cost; and

CMV = the current market value.

In order to calculate the current replacement cost, institutions must update current market values at least monthly.

(4) Institutions must calculate the potential future exposure referred to in paragraph (2) as follows–

(a) the potential future exposure of a netting set is the sum of the potential future exposure of all the transactions included in the netting set, calculated in accordance with sub-paragraph (b);

(b) the potential future exposure of a single transaction is its notional amount multiplied by–

(i) the product of 0.5% and the residual maturity of the transaction expressed in years for interest-rate derivative contracts;

(ii) the product of 6% and the residual maturity of the transaction expressed in years for credit derivative contracts;

(iii) 4% for foreign-exchange derivatives;

(iv) 18% for gold and commodity derivatives other than electricity derivatives;

(v) 40% for electricity derivatives;

(vi) 32% for equity derivatives;

(c) the notional amount referred to in sub-paragraph (b) is determined in accordance with Article 279B(2) and (3) for all derivatives listed in that sub-paragraph; in addition, the notional amount of the derivatives referred to in sub-paragraphs (b)(iii) to (b)(vi) are determined in accordance with Article 279B(1)(b) and (c);

(d) the potential future exposure of netting sets referred to in paragraph (3)(a) must be multiplied by 0.42.

For calculating the potential exposure of interest-rate derivatives and credit derivatives in accordance with sub-paragraphs (b)(i) and (b)(ii), an institution may choose to use the original maturity instead of the residual maturity of the contracts.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Internal model method

Approval to use the Internal Model Method.

283.(1) Provided that the GFSC is satisfied that the requirement in paragraph (2) have been met by an institution, it must permit that institution to use the Internal Model Method (IMM) to calculate the exposure value for any of the following transactions–

(a) transactions in Article 273(2)(a);

(b) transactions in Article 273(2)(b), (c) and (d);

(c) transactions in Article 273(2)(a) to (d),

Where an institution is permitted to use the IMM to calculate exposure value for any of the transactions mentioned in sub-paragraphs (a) to (c), it may also use the IMM for the transactions in Article 273(2)(e).

Despite the third sub-paragraph of Article 273(1), an institution may choose not to apply this method to exposures that are immaterial in size and risk. In such case, an institution must apply one of the methods set out in Articles 274 to 282 to these exposures where the relevant requirements for each approach are met.

(2) The GFSC must permit institutions to use IMM for the calculations referred to in paragraph (1) only if the institution has demonstrated that it complies with the requirements set out in Articles 283 to 294, and the GFSC verified that the systems for the management of CCR maintained by the institution are sound and properly implemented.

(3) The GFSC may permit institutions for a limited period to implement the IMM sequentially across different transaction types. During this period of sequential implementation institutions may use the methods set out in Articles 274 to 280F and Article 282 for transaction type for which they do not use the IMM.

(4) For all OTC derivative transactions, and for long settlement transactions for which an institution has not received approval under paragraph (1) to use the IMM, the institution must use the methods set out in Articles 274 to 280F. Those methods may be used in combination on a permanent basis within a group.

(5) An institution which is permitted in accordance with paragraph (1) to use the IMM must not revert to the use of the methods set out in Articles 274 to 280f and Article 282 unless it has

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

the GFSC's approval to do so. The GFSC must consider whether the institution demonstrates good cause before granting such approval.

(6) If an institution ceases to comply with the requirements laid down in Articles 283 to 294, it must notify the GFSC and do one of the following–

(a) present to the GFSC a plan for a timely return to compliance;

(b) demonstrate to the satisfaction of the GFSC that the effect of non-compliance is immaterial.

Exposure value.

284.(1) Where an institution is permitted, in accordance with Article 283(1), to use the IMM to calculate the exposure value of some or all transactions mentioned in that paragraph, it must measure the exposure value of those transactions at the level of the netting set.

The model used by the institution for that purpose must–

(a) specify the forecasting distribution for changes in the market value of the netting set attributable to joint changes in relevant market variables, such as interest rates, foreign exchange rates;

(b) calculate the exposure value for the netting set at each of the future dates on the basis of the joint changes in the market variables.

(2) In order for the model to capture the effects of margining, the model of the collateral value must meet the quantitative, qualitative and data requirements for the IMM in accordance with Articles 283 to 294 and the institution may include in its forecasting distributions for changes in the market value of the netting set only eligible financial collateral as referred to in Articles 197 and 198 and Article 299(2)(c) and (d).

(3) The own funds requirement for counterparty credit risk with respect to the CCR exposures to which an institution applies the IMM, must be the higher of the following–

(a) the own funds requirement for those exposures calculated on the basis of Effective EPE using current market data;

(b) the own funds requirement for those exposures calculated on the basis of Effective EPE using a single consistent stress calibration for all CCR exposures to which they apply the IMM.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(4) Except for counterparties identified as having Specific Wrong-Way risk that fall within the scope of Article 291(4) and (5), institutions must calculate the exposure value as the product of alpha (α) times Effective EPE, as follows–

Exposure value = α · Effective EPE

where–

α = 1.4, unless the GFSC requires a higher α or permit institutions to use their own estimates in accordance with paragraph (9);

Effective EPE must be calculated by estimating expected exposure (EEt) as the average exposure at future date t, where the average is taken across possible future values of relevant market risk factors.

The model must estimate EE at a series of future dates t1, t2, t3, etc.

(5) Effective EE must be calculated recursively as–

$$\text{Effective EE}_{tk} = \max\{\text{Effective EE}_{tk-1}, \text{EE}_{tk}\}$$

where–

the current date is denoted as t 0 ;

Effective EE t0 equals current exposure.

(6) Effective EPE is the average Effective EE during the first year of future exposure. If all contracts in the netting set mature within less than one year, EPE is the average of EE until all contracts in the netting set mature. Effective EPE is calculated as a weighted average of Effective EE–

$$Effective\ EPE = \frac{1}{\min\{1year,\ maturity\}} \times \sum_{k=1}^{\min\{1year,\ maturity\}} Effective\ EE_{t_k} \times \Delta t_k$$

where the weights

$$\Delta t_k = t_k - t_{k-1}$$

allow for the case when future exposure is calculated at dates that are not equally spaced over time.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(7) Institutions must calculate EE or peak exposure measures on the basis of a distribution of exposures that accounts for the possible non-normality of the distribution of exposures.

(8) An institution may use a measure of the distribution calculated by the IMM that is more conservative than α multiplied by Effective EPE as calculated in accordance with the equation in paragraph (4) for every counterparty.

(9) Despite paragraph (4), the GFSC may permit institutions to use their own estimates of alpha, where–

(a) alpha must equal the ratio of internal capital from a full simulation of CCR exposure across counterparties (numerator) and internal capital based on EPE (denominator);

(b) in the denominator, EPE must be used as if it were a fixed outstanding amount.

When estimated in accordance with this paragraph, alpha must be no lower than 1.2.

(10) For the purposes of an estimate of alpha under paragraph (9), an institution must ensure that the numerator and denominator are calculated in a manner consistent with the modelling methodology, parameter specifications and portfolio composition. The approach used to estimate α is based on the institution's internal capital approach, be well documented and be subject to independent validation. In addition, an institution must review its estimates of alpha on at least a quarterly basis, and more frequently when the composition of the portfolio varies over time. An institution must also assess the model risk.

(11) An institution must demonstrate to the satisfaction of the GFSC that its internal estimates of alpha capture in the numerator material sources of dependency of distribution of market values of transactions or of portfolios of transactions across counterparties. Internal estimates of alpha must take account of the granularity of portfolios.

(12) In supervising the use of estimates under paragraph (9), the GFSC must have regard to the significant variation in estimates of alpha that arises from the potential for mis-specification in the models used for the numerator, especially where convexity is present.

(13) Where appropriate, volatilities and correlations of market risk factors used in the joint modelling of market and credit risk must be conditioned on the credit risk factor to reflect potential increases in volatility or correlation in an economic downturn.

Exposure value for netting sets subject to a margin agreement.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

285.(1) If the netting set is subject to a margin agreement and daily mark-to-market valuation, the institution must calculate Effective EPE as set out in this paragraph. If the model captures the effects of margining when estimating EE, the institution may, subject to GFSC approval, use the model's EE measure directly in the equation in Article 284(5). The GFSC, when considering an application, must verify that the model properly captures the effects of margining when estimating EE. An institution that has not received such approval must use one of the following Effective EPE measures–

(a) Effective EPE, calculated without taking into account any collateral held or posted by way of margin plus any collateral that has been posted to the counterparty independent of the daily valuation and margining process or current exposure;

(b) Effective EPE, calculated as the potential increase in exposure over the margin period of risk, plus the larger of–

(i) the current exposure including all collateral currently held or posted, other than collateral called or in dispute;

(ii) the largest net exposure, including collateral under the margin agreement, that would not trigger a collateral call. This amount must reflect all applicable thresholds, minimum transfer amounts, independent amounts and initial margins under the margin agreement.

For the purposes of sub-paragraph (b), institutions must calculate the add-on as the expected positive change of the mark-to-market value of the transactions during the margin period of risk. Changes in the value of collateral must be reflected using the Supervisory Volatility Adjustments Approach in accordance with Articles 218 to 236 or the own estimates of volatility adjustments of the Financial Collateral Comprehensive Method, but no collateral payments are assumed during the margin period of risk. The margin period of risk is subject to the minimum periods set out in paragraphs (2) to (5).

(2) For transactions subject to daily re-margining and mark-to-market valuation, the margin period of risk used for the purpose of modelling the exposure value with margin agreements must not be less than–

(a) 5 business days for netting sets consisting only of repurchase transactions, securities or commodities lending or borrowing transactions and margin lending transactions;

(b) 10 business days for all other netting sets.

(3) Paragraph (2)(a) and (b) are subject to the following exceptions–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) for all netting sets where the number of trades exceeds 5000 at any point during a quarter, the margin period of risk for the following quarter must not be less than 20 business days. This exception must not apply to institutions' trade exposures;

(b) for netting sets containing one or more trades involving either illiquid collateral, or an OTC derivative that cannot be easily replaced, the margin period of risk must not be less than 20 business days.

An institution must determine whether collateral is illiquid or whether OTC derivatives cannot be easily replaced in the context of stressed market conditions, characterised by the absence of continuously active markets where a counterparty would, within two days or fewer, obtain multiple price quotations that would not move the market or represent a price reflecting a market discount (in the case of collateral) or premium (in the case of an OTC derivative).

An institution must consider whether trades or securities it holds as collateral are concentrated in a particular counterparty and if that counterparty exited the market precipitously whether the institution would be able to replace those trades or securities.

(4) If an institution has been involved in more than two margin call disputes on a particular netting set over the immediately preceding two quarters that have lasted longer than the applicable margin period of risk under paragraphs (2) and (3), the institution must use a margin period of risk that is at least double the period specified in paragraphs (2) and (3) for that netting set for the subsequent two quarters.

(5) For re-margining with a periodicity of N days, the margin period of risk must be at least equal to the period specified in paragraphs (2) and (3), F, plus N days minus one day. That is–

$$\text{Margin Period of Risk} = F + N - 1$$

(6) If the internal model includes the effect of margining on changes in the market value of the netting set, an institution must model collateral, other than cash of the same currency as the exposure itself, jointly with the exposure in its exposure value calculations for OTC derivatives and securities-financing transactions.

(7) If an institution is not able to model collateral jointly with the exposure, it must not recognise in its exposure value calculations for OTC derivatives and securities-financing transactions the effect of collateral other than cash of the same currency as the exposure itself, unless it uses either volatility adjustments that meet the standards of the financial collateral comprehensive Method with own volatility adjustments estimates or the standard Supervisory Volatility Adjustments Approach in accordance with Chapter 4.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(8) An institution using the IMM must ignore in its models the effect of a reduction of the exposure value due to any clause in a collateral agreement that requires receipt of collateral when counterparty credit quality deteriorates.

Management of CCR — Policies, processes and systems.

286.(1) An institution must establish and maintain a CCR management framework, consisting of–

(a) policies, processes and systems to ensure the identification, measurement, management, approval and internal reporting of CCR;

(b) procedures for ensuring that those policies, processes and systems are complied with.

Those policies, processes and systems must be conceptually sound, implemented with integrity and documented. The documentation must include an explanation of the empirical techniques used to measure CCR.

(2) The CCR management framework required by paragraph (1) must take account of market, liquidity, and legal and operational risks that are associated with CCR. In particular, the framework must ensure that the institution complies with the following principles–

(a) it does not undertake business with a counterparty without assessing its creditworthiness;

(b) it takes due account of settlement and pre-settlement credit risk;

(c) it manages such risks as comprehensively as practicable at the counterparty level by aggregating CCR exposures with other credit exposures and at the firm-wide level.

(3) An institution using the IMM must ensure that its CCR management framework accounts to the satisfaction of the competent authority for the liquidity risks of all of the following–

(a) potential incoming margin calls in the context of exchanges of variation margin or other margin types, such as initial or independent margin, under adverse market shocks;

(b) potential incoming calls for the return of excess collateral posted by counterparties;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(c) calls resulting from a potential downgrade of its own external credit quality assessment.

An institution must ensure that the nature and horizon of collateral re-use is consistent with its liquidity needs and does not jeopardise its ability to post or return collateral in a timely manner.

(4) An institution's management body and senior management must be actively involved in, and ensure that adequate resources are allocated to, the management of CCR. Senior management must be aware of the limitations and assumptions of the model used and the impact those limitations and assumptions can have on the reliability of the output through a formal process. Senior management must be also aware of the uncertainties of the market environment and operational issues and of how these are reflected in the model.

(5) The daily reports prepared on an institution's exposures to CCR in accordance with Article 287(2)(b) must be reviewed by a level of management with sufficient seniority and authority to enforce both reductions of positions taken by individual credit managers or traders and reductions in the institution's overall CCR exposure.

(6) An institution's CCR management framework established in accordance with paragraph (1) must be used in conjunction with internal credit and trading limits. Credit and trading limits must be related to the institution's risk measurement model in a manner that is consistent over time and that is well understood by credit managers, traders and senior management. An institution must have a formal process to report breaches of risk limits to the appropriate level of management.

(7) An institution's measurement of CCR must include measuring daily and intra-day use of credit lines. The institution must measure current exposure gross and net of collateral. At portfolio and counterparty level, the institution must calculate and monitor peak exposure or potential future exposure at the confidence interval chosen by the institution. The institution must take account of large or concentrated positions, including by groups of related counterparties, by industry and by market.

(8) An institution must establish and maintain a routine and rigorous program of stress testing. The results of that stress testing must be reviewed regularly and at least quarterly by senior management and must be reflected in the CCR policies and limits set by the management body or senior management. Where stress tests reveal particular vulnerability to a given set of circumstances, the institution must take prompt steps to manage those risks.

Organisation structures for CCR management.

287.(1) An institution using the IMM must establish and maintain–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) a risk control unit that complies with paragraph (2);

(b) a collateral management unit that complies with paragraph (3).

(2) The risk control unit must be responsible for the design and implementation of its CCR management, including the initial and on-going validation of the model, and must carry out the following functions and meet the following requirements–

(a) it must be responsible for the design and implementation of the CCR management system of the institution;

(b) it must produce daily reports on and analyse the output of the institution's risk measurement model. That analysis must include an evaluation of the relationship between measures of CCR exposure values and trading limits;

(c) it must control input data integrity and produce and analyse reports on the output of the institution's risk measurement model, including an evaluation of the relationship between measures of risk exposure and credit and trading limits;

(d) it must be independent from units responsible for originating, renewing or trading exposures and free from undue influence;

(e) it must be adequately staffed;

(f) it must report directly to the senior management of the institution;

(g) its work must be closely integrated into the day-to-day credit risk management process of the institution;

(h) its output must be an integral part of the process of planning, monitoring and controlling the institution's credit and overall risk profile.

(3) The collateral management unit must carry out the following tasks and functions–

(a) calculating and making margin calls, managing margin call disputes and reporting levels of independent amounts, initial margins and variation margins accurately on a daily basis;

(b) controlling the integrity of the data used to make margin calls, and ensuring that it is consistent and reconciled regularly with all relevant sources of data within the institution;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(c) tracking the extent of re-use of collateral and any amendment of the rights of the institution to or in connection with the collateral that it posts;

(d) reporting to the appropriate level of management the types of collateral assets that are reused, and the terms of such reuse including instrument, credit quality and maturity;

(e) tracking concentration to individual types of collateral assets accepted by the institution;

(f) reporting collateral management information on a regular basis, but at least quarterly, to senior management, including information on the type of collateral received and posted, the size, aging and cause for margin call disputes. That internal reporting must also reflect trends in these figures.

(4) Senior management must allocate sufficient resources to the collateral management unit required under paragraph (1)(b) to ensure that its systems achieve an appropriate level of operational performance, as measured by the timeliness and accuracy of margin calls by the institution and the timeliness of the response of the institution to margin calls by its counterparties. Senior management must ensure that the unit is adequately staffed to process calls and disputes in a timely manner even under severe market crisis, and to enable the institution to limit its number of large disputes caused by trade volumes.

Review of CCR management system.

288. An institution must regularly conduct an independent review of its CCR management system through its internal auditing process. That review must include both the activities of the control and collateral management units required by Article 287 and must specifically address, as a minimum–

(a) the adequacy of the documentation of the CCR management system and process required by Article 286;

(b) the organisation of the CCR control unit required by Article 287(1)(a);

(c) the organisation of the collateral management unit required by Article 287(1)(b);

(d) the integration of CCR measures into daily risk management;

(e) the approval process for risk pricing models and valuation systems used by front and back-office personnel;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(f) the validation of any significant change in the CCR measurement process;

(g) the scope of CCR captured by the risk measurement model;

(h) the integrity of the management information system;

(i) the accuracy and completeness of CCR data;

(j) the accurate reflection of legal terms in collateral and netting agreements into exposure value measurements;

(k) the verification of the consistency, timeliness and reliability of data sources used to run models, including the independence of such data sources;

(l) the accuracy and appropriateness of volatility and correlation assumptions;

(m) the accuracy of valuation and risk transformation calculations;

(n) the verification of the model's accuracy through frequent back-testing as set out in Article 293(1)(b) to (e);

(o) the compliance of the CCR control unit and collateral management unit with the relevant regulatory requirements.

Use test.

289.(1) Institutions must ensure that the distribution of exposures generated by the model used to calculate Effective EPE is closely integrated into the day-to-day CCR management process of the institution, and that the output of the model is taken into account in the process of credit approval, CCR management, internal capital allocation and corporate governance.

(2) The institution must demonstrate to the satisfaction of the GFSC that it has been using a model to calculate the distribution of exposures upon which the EPE calculation is based that meets, broadly, the requirements set out in Articles 283 to 294 for at least one year prior to approval to use the IMM by the GFSC in accordance with Article 283.

(3) The model used to generate a distribution of exposures to CCR must be part of the CCR management framework required by Article 286. This framework must include the measurement of usage of credit lines, aggregating CCR exposures with other credit exposures and internal capital allocation.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(4) In addition to EPE, an institution must measure and manage current exposures. Where appropriate, the institution must measure current exposure gross and net of collateral. The use test is satisfied if an institution uses other CCR measures, such as peak exposure, based on the distribution of exposures generated by the same model to compute EPE.

(5) An institution must have the systems capability to estimate EE daily if necessary, unless it demonstrates to the satisfaction of the GFSC that its exposures to CCR warrant less frequent calculation. The institution must estimate EE along a time profile of forecasting horizons that adequately reflects the time structure of future cash flows and maturity of the contracts and in a manner that is consistent with the materiality and composition of the exposures.

(6) Exposure must be measured, monitored and controlled over the life of all contracts in the netting set and not only to the one-year horizon. The institution must have procedures in place to identify and control the risks for counterparties where the exposure rises beyond the one-year horizon. The forecast increase in exposure must be an input into the institution's internal capital model.

Stress testing.

290.(1) An institution must have a comprehensive stress testing programme for CCR, including for use in assessment of own funds requirements for CCR, which complies with the requirements laid down in paragraphs (2) to (10).

(2) It must identify possible events or future changes in economic conditions that could have unfavourable effects on an institution's credit exposures and assess the institution's ability to withstand such changes.

(3) The stress measures under the programme must be compared against risk limits and considered by the institution as part of the process established in accordance with regulation 38 of the CICR Regulations.

(4) The programme must comprehensively capture trades and aggregate exposures across all forms of counterparty credit risk at the level of specific counterparties in a sufficient time frame to conduct regular stress testing.

(5) It must provide for at least monthly exposure stress testing of principal market risk factors such as interest rates, FX, equities, credit spreads, and commodity prices for all counterparties of the institution, in order to identify, and enable the institution when necessary to reduce outsized concentrations in specific directional risks. Exposure stress testing -including single factor, multifactor and material non-directional risks- and joint stressing of exposure and creditworthiness is performed at the counterparty-specific, counterparty group and aggregate institution-wide CCR levels.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(6) It must apply at least quarterly multifactor stress testing scenarios and assess material non-directional risks including yield curve exposure and basis risks. Multiple-factor stress tests must, at a minimum, address the following scenarios in which the following occurs–

(a) severe economic or market events have occurred;

(b) broad market liquidity has decreased significantly;

(c) a large financial intermediary is liquidating positions.

(7) The severity of the shocks of the underlying risk factors must be consistent with the purpose of the stress test. When evaluating solvency under stress, the shocks of the underlying risk factors must be sufficiently severe to capture historical extreme market environments and extreme but plausible stressed market conditions. The stress tests must evaluate the impact of such shocks on own funds, own funds requirements and earnings. For the purpose of day-to-day portfolio monitoring, hedging, and management of concentrations the testing programme must also consider scenarios of lesser severity and higher probability.

(8) The programme must include provision, where appropriate, for reverse stress tests to identify extreme, but plausible, scenarios that could result in significant adverse outcomes. Reverse stress testing must account for the impact of material non-linearity in the portfolio.

(9) The results of the stress testing under the programme must be reported regularly, at least on a quarterly basis, to senior management. The reports and analysis of the results must cover the largest counterparty-level impacts across the portfolio, material concentrations within segments of the portfolio (within the same industry or region), and relevant portfolio and counterparty specific trends.

(10) Senior management must take a lead role in the integration of stress testing into the risk management framework and risk culture of the institution and ensure that the results are meaningful and used to manage CCR. The results of stress testing for significant exposures must be assessed against guidelines that indicate the institution's risk appetite, and referred to senior management for discussion and action when excessive or concentrated risks are identified.

Wrong-Way Risk.

291(1) For the purposes of this Article–

(a) “General Wrong-Way risk” arises when the likelihood of default by counterparties is positively correlated with general market risk factors;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(b) "Specific Wrong-Way risk" arises when future exposure to a specific counterparty is positively correlated with the counterparty's PD due to the nature of the transactions with the counterparty. An institution must be considered to be exposed to Specific Wrong-Way risk if the future exposure to a specific counterparty is expected to be high when the counterparty's probability of a default is also high.

(2) An institution must give due consideration to exposures that give rise to a significant degree of Specific and General Wrong-Way risk.

(3) In order to identify General Wrong-Way risk, an institution must design stress testing and scenario analyses to stress risk factors that are adversely related to counterparty creditworthiness. Such testing must address the possibility of severe shocks occurring when relationships between risk factors have changed. An institution must monitor General Wrong Way risk by product, by region, by industry, or by other categories that are relevant to the business.

(4) An institution must maintain procedures to identify, monitor and control cases of Specific Wrong-Way risk for each legal entity, beginning at the inception of a transaction and continuing through the life of the transaction.

(5) Institutions must calculate the own funds requirements for CCR in relation to transactions where Specific Wrong-Way risk has been identified and where there exists a legal connection between the counterparty and the issuer of the underlying of the OTC derivative or the underlying of the transactions referred to in Article 273(2)(b), (c) and (d), in accordance with the following principles–

(a) the instruments where Specific Wrong-Way risk exists must not be included in the same netting set as other transactions with the counterparty, and must each be treated as a separate netting set;

(b) within any such separate netting set, for single-name credit default swaps the exposure value equals the full expected loss in the value of the remaining fair value of the underlying instruments based on the assumption that the underlying issuer is in liquidation;

(c) LGD for an institution using the approach set out in Chapter 3 must be 100% for such swap transactions;

(d) for an institution using the approach set out in Chapter 2, the applicable risk weight must be that of an unsecured transaction;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(e) for all other transactions referencing a single name in any such separate netting set, the calculation of the exposure value must be consistent with the assumption of a jump-to-default of those underlying obligations where the issuer is legally connected with the counterparty. For transactions referencing a basket of names or index, the jump-to-default of the respective underlying obligations where the issuer is legally connected with the counterparty, must be applied, if material;

(f) to the extent that this uses existing market risk calculations for own funds requirements for incremental default and migration risk as set out in Articles 372 to 376 that already contain an LGD assumption, the LGD in the formula used must be 100%.

(6) Institutions must provide senior management and the appropriate committee of the management body with regular reports on both Specific and General Wrong-Way risks and the steps being taken to manage those risks.

Integrity of the modelling process.

292.(1) An institution must ensure the integrity of modelling process as set out in Article 284 by adopting at least the following measures–

(a) the model must reflect transaction terms and specifications in a timely, complete, and conservative fashion;

(b) those terms must include at least contract notional amounts, maturity, reference assets, margining arrangements and netting arrangements;

(c) those terms and specifications must be maintained in a database that is subject to formal and periodic audit;

(d) a process for recognising netting arrangements that requires legal staff to verify that netting under those arrangements is legally enforceable;

(e) the verification required under sub-paragraph (d) must be entered into the database mentioned in sub-paragraph (c) by an independent unit;

(f) the transmission of transaction terms and specification data to the EPE model must be subject to internal audit;

(g) there must be processes for formal reconciliation between the model and source data systems to verify on an ongoing basis that transaction terms and specifications are being reflected in EPE correctly or at least conservatively.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(2) Current market data must be used to determine current exposures. An institution may calibrate its EPE model using either historic market data or market implied data to establish parameters of the underlying stochastic processes, such as drift, volatility and correlation. If an institution uses historical data, it must use at least three years of such data. The data must be updated at least quarterly, and more frequently if necessary to reflect market conditions.

To calculate the Effective EPE using a stress calibration, an institution must calibrate Effective EPE using either three years of data that includes a period of stress to the credit default spreads of its counterparties or market implied data from such a period of stress.

The requirements in paragraphs (3), (4) and (5) must be applied by the institution for that purpose.

(3) An institution must demonstrate to the satisfaction of the GFSC, at least quarterly, that the stress period used for the calculation under this paragraph coincides with a period of increased credit default swap or other credit (such as loan or corporate bond) spreads for a representative selection of its counterparties with traded credit spreads. In situations where the institution does not have adequate credit spread data for a counterparty, it must map that counterparty to specific credit spread data based on region, internal rating and business types.

(4) The EPE model for all counterparties must use data, either historic or implied, that include the data from the stressed credit period and must use such data in a manner consistent with the method used for the calibration of the EPE model to current data.

(5) To evaluate the effectiveness of its stress calibration for EEPE, an institution must create several benchmark portfolios that are vulnerable to the main risk factors to which the institution is exposed. The exposure to these benchmark portfolios is calculated using–

(a) a stress methodology, based on current market values and model parameters calibrated to stressed market conditions; and

(b) the exposure generated during the stress period, but applying the method set out in Articles 283 to 294 (end of stress period market value, volatilities, and correlations from the 3-year stress period).

The GFSC must require an institution to adjust the stress calibration if the exposures of those benchmark portfolios deviate substantially from each other.

(6) An institution must subject the model to a validation process that is clearly articulated in the institutions' policies and procedures. That validation process must–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) specify the kind of testing needed to ensure model integrity and identify conditions under which the assumptions underlying the model are inappropriate and may therefore result in an understatement of EPE;

(b) include a review of the comprehensiveness of the model.

(7) An institution must monitor the relevant risks and have processes in place to adjust its estimation of Effective EPE when those risks become significant. In complying with this paragraph, the institution must–

(a) identify and manage its exposures to Specific Wrong-Way risk arising as specified in Article 291(1)(b) and exposures to General Wrong-Way risk arising as specified in Article 291(1)(a);

(b) for exposures with a rising risk profile after one year, compare on a regular basis the estimate of a relevant measure of exposure over one year with the same exposure measure over the life of the exposure;

(c) for exposures with a residual maturity below one year, compare on a regular basis the replacement cost (current exposure) and the realised exposure profile, and store data that would allow such a comparison.

(8) An institution must have internal procedures to verify that, prior to including a transaction in a netting set, the transaction is covered by a legally enforceable netting contract that meets the requirements set out in Articles 295 to 298.

(9) An institution that uses collateral to mitigate its CCR must have internal procedures to verify that, prior to recognising the effect of collateral in its calculations, the collateral meets the legal certainty standards set out in Chapter 4.

Requirements for the risk management system.

293.(1) An institution must comply with the following requirements–

(a) it must meet the qualitative requirements set out in Part 3, Title 4, Chapter 5;

(b) it must conduct a regular programme of back-testing, comparing the risk measures generated by the model with realised risk measures, and hypothetical changes based on static positions with realised measures;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(c) it must carry out an initial validation and an on-going periodic review of its CCR exposure model and the risk measures generated by it. The validation and review must be independent of the model development;

(d) the management body and senior management must be involved in the risk control process and must ensure that adequate resources are devoted to credit and counterparty credit risk control. In this regard, the daily reports prepared by the independent risk control unit established in accordance Article 287(1)(a) must be reviewed by a level of management with sufficient seniority and authority to enforce both reductions of positions taken by individual traders and reductions in the overall risk exposure of the institution;

(e) the internal risk measurement exposure model must be integrated into the day-to-day risk management process of the institution;

(f) the risk measurement system must be used in conjunction with internal trading and exposure limits. In this regard, exposure limits must be related to the institution's risk measurement model in a manner that is consistent over time and that is well understood by traders, the credit function and senior management;

(g) an institution must ensure that its risk management system is well documented. In particular, it must maintain a documented set of internal policies, controls and procedures concerning the operation of the risk measurement system, and arrangements to ensure that those policies are complied with;

(h) an independent review of the risk measurement system must be carried out regularly in the institution's own internal auditing process. This review must include both the activities of the business trading units and of the independent risk control unit. A review of the overall risk management process must take place at regular intervals (and no less than once a year) and must specifically address, as a minimum, all items referred to in Article 288;

(i) the on-going validation of counterparty credit risk models, including back-testing, must be reviewed periodically by a level of management with sufficient authority to decide the action that will be taken to address weaknesses in the models.

(2) The GFSC must take into account the extent to which an institution meets the requirements of paragraph (1) when setting the level of alpha, as set out in Article 284(4). Only those institutions that comply fully with those requirements must be eligible for application of the minimum multiplication factor.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(3) An institution must document the process for initial and on-going validation of its CCR exposure model and the calculation of the risk measures generated by the models to a level of detail that would enable a third party to recreate, respectively, the analysis and the risk measures. That documentation must set out the frequency with which back testing analysis and any other on-going validation will be conducted, how the validation is conducted with respect to data flows and portfolios and the analyses that are used.

(4) An institution must define criteria with which to assess its CCR exposure models and the models that input into the calculation of exposure and maintain a written policy that describes the process by which unacceptable performance will be identified and remedied.

(5) An institution must define how representative counterparty portfolios are constructed for the purposes of validating an CCR exposure model and its risk measures.

(6) The validation of CCR exposure models and their risk measures that produce forecast distributions must consider more than a single statistic of the forecast distribution.

Validation requirements.

294.(1) As part of the initial and on-going validation of its CCR exposure model and its risk measures, an institution must ensure that the following requirements are met–

(a) the institution must carry out back-testing using historical data on movements in market risk factors prior to the GFSC's approval in accordance with Article 283(1). That back-testing must consider a number of distinct prediction time horizons out to at least one year, over a range of various initialisation dates and covering a wide range of market conditions;

(b) the institution using the approach set out in Article 285(1)(b) must regularly validate its model to test whether realised current exposures are consistent with prediction over all margin periods within one year. If some of the trades in the netting set have a maturity of less than one year, and the netting set has higher risk factor sensitivities without these trades, the validation must take this into account;

(c) it must back-test the performance of its CCR exposure model and the model's relevant risk measures as well as the market risk factor predictions. For collateralised trades, the prediction time horizons considered must include those reflecting typical margin periods of risk applied in collateralised or margined trading;

(d) if the model validation indicates that Effective EPE is underestimated, the institution must take the action necessary to address the inaccuracy of the model;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(e) it must test the pricing models used to calculate CCR exposure for a given scenario of future shocks to market risk factors as part of the initial and on-going model validation process. Pricing models for options must account for the nonlinearity of option value with respect to market risk factors;

(f) the CCR exposure model must capture the transaction-specific information necessary to be able to aggregate exposures at the level of the netting set. An institution must verify that transactions are assigned to the appropriate netting set within the model;

(g) the CCR exposure model must include transaction-specific information to capture the effects of margining. It must take into account both the current amount of margin and margin that would be passed between counterparties in the future. Such a model must account for the nature of margin agreements that are unilateral or bilateral, the frequency of margin calls, the margin period of risk, the minimum threshold of un-margined exposure the institution is willing to accept, and the minimum transfer amount. Such a model must either estimate the mark-to-market change in the value of collateral posted or apply the rules set out in Chapter 4;

(h) the model validation process must include static, historical back-testing on representative counterparty portfolios. An institution must conduct such back-testing on a number of representative counterparty portfolios that are actual or hypothetical at regular intervals. Those representative portfolios must be chosen on the basis of their sensitivity to the material risk factors and combinations of risk factors to which the institution is exposed;

(i) an institution must conduct back-testing that is designed to test the key assumptions of the CCR exposure model and the relevant risk measures, including the modelled relationship between tenors of the same risk factor, and the modelled relationships between risk factors;

(j) the performance of CCR exposure models and its risk measures must be subject to appropriate back-testing practice. The back testing programme must be capable of identifying poor performance in an EPE model's risk measures;

(k) an institution must validate its CCR exposure models and all risk measures out to time horizons commensurate with the maturity of trades for which exposure is calculated using IMM in accordance with Article 283;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(l) an institution must regularly test the pricing models used to calculate counterparty exposure against appropriate independent benchmarks as part of the on-going model validation process;

(m) the on-going validation of an institution's CCR exposure model and the relevant risk measures must include an assessment of the adequacy of the recent performance;

(n) the frequency with which the parameters of an CCR exposure model are updated must be assessed by an institution as part of the initial and on-going validation process;

(o) the initial and on-going validation of CCR exposure models must assess whether or not the counterparty level and netting set exposure calculations of exposure are appropriate.

(2) A measure that is more conservative than the metric used to calculate regulatory exposure value for every counterparty may be used in place of alpha multiplied by Effective EPE with GFSC approval. The degree of relative conservatism will be assessed upon initial approval by the GFSC and at the regular supervisory reviews of the EPE models. An institution must validate the conservatism regularly. The on-going assessment of model performance must cover all counterparties for which the models are used.

(3) If back-testing indicates that a model is not sufficiently accurate, the GFSC must revoke its approval for the model, or impose appropriate measures to ensure that the model is improved promptly.

Contractual netting

Recognition of contractual netting as risk-reducing.

295. Institutions may treat as risk reducing in accordance with Article 298 only the following types of contractual netting agreements where the netting agreement has been recognised by the GFSC in accordance with Article 296 and where the institution meets the requirements set out in Article 297–

(a) bilateral contracts for novation between an institution and its counterparty under which mutual claims and obligations are automatically amalgamated in such a way that the novation fixes one single net amount each time it applies so as to create a single new contract that replaces all former contracts and all obligations between parties pursuant to those contracts and is binding on the parties;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(b) other bilateral agreements between an institution and its counterparty;

(c) contractual cross-product netting agreements for institutions that have received the approval to use the method set out in Articles 283 to 294 for transactions falling under the scope of that method.

Netting across transactions entered into by different legal entities of a group are not recognised for the purposes of calculating the own funds requirements.

Recognition of contractual netting agreements.

296.(1) The GFSC must recognise a contractual netting agreement only where the conditions in paragraph (2) and, where relevant, (3) are fulfilled.

(2) The following conditions must be fulfilled by all contractual netting agreements used by an institution for the purposes of determining exposure value in this Part–

(a) the institution has concluded a contractual netting agreement with its counterparty which creates a single legal obligation, covering all included transactions, such that, in the event of default by the counterparty it would be entitled to receive or obliged to pay only the net sum of the positive and negative mark-to-market values of included individual transactions;

(b) the institution has made available to the GFSC written and reasoned legal opinions to the effect that, in the event of a legal challenge of the netting agreement, the institution's claims and obligations would not exceed those referred to in sub-paragraph (a). The legal opinion must refer to the applicable law–

(i) the jurisdiction in which the counterparty is incorporated;

(ii) if a branch of an undertaking is involved, which is located in a country other than that where the undertaking is incorporated, the jurisdiction in which the branch is located;

(iii) the jurisdiction whose law governs the individual transactions included in the netting agreement;

(iv) the jurisdiction whose law governs any contract or agreement necessary to effect the contractual netting;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(c) credit risk to each counterparty is aggregated to arrive at a single legal exposure across transactions with each counterparty. This aggregation must be factored into credit limit purposes and internal capital purposes;

(d) the contract must not contain any clause which, in the event of default of a counterparty, permits a non-defaulting counterparty to make limited payments only, or no payments at all, to the estate of the defaulting party, even if the defaulting party is a net creditor (i.e. walk-away clause).

If the GFSC is not satisfied that the contractual netting is legally valid and enforceable under the law of each of the jurisdictions referred to in sub-paragraph (b) the contractual netting agreement must not be recognised as risk-reducing for either of the counterparties.

(3) The legal opinions referred to in sub-paragraph (b) may be drawn up by reference to types of contractual netting. The following additional conditions must be fulfilled by contractual cross-product netting agreements–

(a) the net sum referred to in paragraph (2)(a) is the net sum of the positive and negative close out values of any included individual bilateral master agreement and of the positive and negative mark-to-market value of the individual transactions (the "cross-product net amount");

(b) the legal opinions referred to in paragraph (2)(b) must address the validity and enforceability of the entire contractual cross-product netting agreement under its terms and the impact of the netting arrangement on the material provisions of any included individual bilateral master agreement.

Obligations of institutions.

297.(1) An institution must establish and maintain procedures to ensure that the legal validity and enforceability of its contractual netting is reviewed in the light of changes in the law of relevant jurisdictions referred to in Article 296(2)(b).

(2) The institution must maintain all required documentation relating to its contractual netting in its files.

(3) The institution must factor the effects of netting into its measurement of each counterparty's aggregate credit risk exposure and the institution must manage its CCR on the basis of those effects of that measurement.

(4) In the case of contractual cross-product netting agreements referred to in Article 295, the institution must maintain procedures under Article 296(2)(c) to verify that any transaction

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

which is to be included in a netting set is covered by a legal opinion referred to in Article 296(2)(b).

Taking into account the contractual cross-product netting agreement, the institution must continue to comply with the requirements for the recognition of bilateral netting and the requirements of Chapter 4 for the recognition of credit risk mitigation, as applicable, with respect to each included individual bilateral master agreement and transaction.

Effects of recognition of netting as risk-reducing.

298. Netting for the purposes of Articles 274 to 294 must be recognised as set out in those Articles.

Items in the trading book

Items in the trading book.

299.(1) For the purposes of the application of this Article, Schedule 2 must include a reference to derivative instruments for the transfer of credit risk as mentioned in paragraph 46(8) of Schedule 2 to the Act.

(2) When calculating risk-weighted exposure amounts for counterparty risk of items in the trading book, institutions must comply with the following principles–

(a) [Not used]

(b) institutions must not use the Financial Collateral Simple Method set out in Article 222 for the recognition of the effects of financial collateral;

(c) in the case of repurchase transactions and securities or commodities lending or borrowing transactions booked in the trading book, institutions may recognise as eligible collateral all financial instruments and commodities that are eligible to be included in the trading book;

(d) for exposures arising from OTC derivative instruments booked in the trading book, institutions may recognise commodities that are eligible to be included in the trading book as eligible collateral;

(e) for the purposes of calculating volatility adjustments where such financial instruments or commodities which are not eligible under Chapter 4 are lent, sold or provided, or borrowed, purchased or received by way of collateral or otherwise under such a transaction, and an institution is using the Supervisory Volatility

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Adjustments Approach under Articles 218 to 236, institutions must treat such instruments and commodities in the same way as non-main index equities listed on a recognised exchange;

(f) where an institution is using the Own Estimates of Volatility adjustments Approach under Articles 218 to 236in respect of financial instruments or commodities which are not eligible under Chapter 4, it must calculate volatility adjustments for each individual item. Where an institution has obtained the approval to use the internal models approach defined in Chapter 4, it may also apply that approach in the trading book;

(g) in relation to the recognition of master netting agreements covering repurchase transactions, securities or commodities lending or borrowing transactions, or other capital market-driven transactions, institutions must only recognise netting across positions in the trading book and the non-trading book when the netted transactions fulfil the following conditions–

(i) all transactions are marked to market daily;

(ii) any items borrowed, purchased or received under the transactions may be recognised as eligible financial collateral under Chapter 4 without the application of sub-paragraphs (c) to (f);

(h) where a credit derivative included in the trading book forms part of an internal hedge and the credit protection is recognised under these Standards in accordance with Article 204, institutions must apply one of the following approaches–

(i) treat it as if there were no counterparty risk arising from the position in that credit derivative;

(ii) consistently include for the purpose of calculating the own funds requirements for counterparty credit risk all credit derivatives in the trading book forming part of internal hedges or purchased as protection against a CCR exposure where the credit protection is recognised as eligible under Chapter 4.

Own funds requirements for exposures to a central counterparty

Definitions.

300. For the purposes of Articles 300 to 311 and of Part 7, the following definitions apply–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

"bankruptcy remote", in relation to client assets, means that effective arrangements exist which ensure that those assets will not be available to the creditors of a CCP or of a clearing member in the event of the insolvency of that CCP or clearing member respectively, or that the assets will not be available to the clearing member to cover losses it incurred following the default of a client or clients other than those that provided those assets;

"CCP-related transaction" means a contract or a transaction listed in Article 301(1) between a client and a clearing member that is directly related to a contract or a transaction listed in that paragraph between that clearing member and a CCP;

"clearing member" means a clearing member as defined in point (14) of Article 2 of EMIR;

"client" means a client as defined in point (15) of Article 2 of EMIR or an undertaking that has established indirect clearing arrangements with a clearing member in accordance with Article 4(3) of that Regulation.

"cash transaction" means a transaction in cash, debt instruments or equities, a spot foreign exchange transaction or a spot commodities transaction; however, repurchase transactions, securities or commodities lending transactions, and securities or commodities borrowing transactions, are not cash transactions;

"indirect clearing arrangement" means an arrangement that meets the conditions set out in the second sub-paragraph of Article 4(3) of EMIR;

"higher-level client" means an entity providing clearing services to a lower-level client;

"lower-level client" means an entity accessing the services of a CCP through a higher-level client;

"multi-level client structure" means an indirect clearing arrangement under which clearing services are provided to an institution by an entity which is not a clearing member, but is itself a client of a clearing member or of a higher-level client;

"unfunded contribution to a default fund" means a contribution that an institution that acts as a clearing member has contractually committed to provide to a CCP after the CCP has depleted its default fund to cover the losses it incurred following the default of one or more of its clearing members;

"fully guaranteed deposit lending or borrowing transaction" means a fully collateralised money market transaction in which two counterparties exchange deposits and a CCP

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

interposes itself between them to ensure the performance of those counterparties' payment obligations.

Material scope.

301.(1) Articles 300 to 311 applies to the following contracts and transactions, for as long as they are outstanding with a CCP–

(a) the derivative contracts listed in Schedule 2 and credit derivatives;

(b) securities financing transactions and fully guaranteed deposit lending or borrowing transactions; and

(c) long settlement transactions.

Articles 300 to 311does not apply to exposures arising from the settlement of cash transactions. Institutions must apply the treatment laid down in Title 5 to trade exposures arising from those transactions and a 0% risk weight to default fund contributions covering only those transactions. Institutions must apply the treatment set out in Article 307 to default fund contributions that cover any of the contracts listed in the first sub-paragraph of this paragraph in addition to cash transactions.

(2) For the purposes of Articles 300 to 311, the following requirements must apply–

(a) the initial margin must not include contributions to a CCP for mutualised loss sharing arrangements;

(b) the initial margin must include collateral deposited by an institution acting as a clearing member or by a client in excess of the minimum amount required respectively by the CCP or by the institution acting as a clearing member, provided the CCP or the institution acting as a clearing member may, in appropriate cases, prevent the institution acting as a clearing member or the client from withdrawing such excess collateral;

(c) where a CCP uses the initial margin to mutualise losses among its clearing members, institutions that act as clearing members must treat that initial margin as a default fund contribution.

Monitoring of exposures to CCPs.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

302.(1) Institutions must monitor all their exposures to CCPs and must lay down procedures for the regular reporting of information on those exposures to senior management and appropriate committee or committees of the management body.

(2) Institutions must assess, through appropriate scenario analysis and stress testing, whether the level of own funds held against exposures to a CCP, including potential future or contingent credit exposures, exposures from default fund contributions and, where the institution is acting as a clearing member, exposures resulting from contractual arrangements as laid down in Article 304, adequately relates to the inherent risks of those exposures.

Treatment of clearing members' exposures to CCPs.

303.(1) An institution that acts as a clearing member, either for its own purposes or as a financial intermediary between a client and a CCP, must calculate the own funds requirements for its exposures to a CCP as follows–

(a) it must apply the treatment set out in Article 306 to its trade exposures with the CCP;

(b) it must apply the treatment set out in Article 307 to its default fund contributions to the CCP.

(2) For the purposes of paragraph (1), the sum of an institution’s own funds requirements for its exposures to a QCCP due to trade exposures and default fund contributions is subject to a cap equal to the sum of own funds requirements that would be applied to those same exposures if the CCP were a non-qualifying CCP.

Treatment of clearing members' exposures to clients.

304.(1) An institution that acts as a clearing member and, in that capacity, acts as a financial intermediary between a client and a CCP must calculate the own funds requirements for its CCP-related transactions with that client in accordance with Articles 218 to 236, 271 to 299 and with Title 6, as applicable.

(2) Where an institution acting as a clearing member enters into a contractual arrangement with a client of another clearing member that facilitates, in accordance with Article 48(5) and (6), of EMIR, the transfer of positions and collateral referred to in Article 305(2)(b) for that client, and that contractual agreement gives rise to a contingent obligation for that institution, that institution may attribute an exposure value of zero to that contingent obligation.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(3) Where an institution that acts as a clearing member uses the methods set out in Articles 274 to 294 to calculate the own funds requirement for its exposures, the following provisions must apply–

(a) by way of derogation from Article 285(2), the institution may use a margin period of risk of at least five business days for its exposures to a client;

(b) the institution must apply a margin period of risk of at least 10 business days for its exposures to a CCP;

(c) by way of derogation from Article 285(3), where a netting set included in the calculation meets the condition set out in sub-paragraph (a) of that paragraph, the institution may disregard the limit set out in that sub-paragraph, if the netting set does not meet the condition set out in sub-paragraph (b) of that paragraph and does not contain disputed trades or exotic options;

(d) where a CCP retains variation margin against a transaction, and the institution's collateral is not protected against the insolvency of the CCP, the institution must apply a margin period of risk that is the lower of one year and the remaining maturity of the transaction, with a floor of 10 business days.

(4) By way of derogation from Article 281(2)(i), where an institution that acts as a clearing member uses the method set out in Article 281 to calculate the own funds requirement for its exposures to a client, the institution may use a maturity factor of 0.21 for its calculation.

(5) By way of derogation from Article 282(4)(d), where an institution that acts as a clearing member uses the method set out in Article 282 to calculate the own funds requirement for its exposures to a client, that institution may use a maturity factor of 0.21 in that calculation

(6) An institution that acts as a clearing member may use the reduced exposure at default resulting from the calculations set out in paragraphs (3), (4) and (5) for the purposes of calculating its own funds requirements for CVA risk in accordance with Title 6.

(7) An institution that acts as a clearing member that collects collateral from a client for a CCP-related transaction and passes the collateral on to the CCP may recognise that collateral to reduce its exposure to the client for that CCP-related transaction.

In the case of a multi-level client structure, the treatment set out in the first sub-paragraph may be applied at each level of that structure.

Treatment of clients' exposures.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

305.(1) An institution that is a client must calculate the own funds requirements for its CCP-related transactions with its clearing member in accordance with Articles 218 to 236, 271 to 299 and with Title 6, as applicable.

(2) Without prejudice to the approach specified in paragraph (1), where an institution is a client, it may calculate the own funds requirements for its trade exposures for CCP-related transactions with its clearing member in accordance with Article 306 if all the following conditions are met–

(a) the positions and assets of that institution related to those transactions are distinguished and segregated, at the level of both the clearing member and the CCP, from the positions and assets of both the clearing member and the other clients of that clearing member and as a result of that distinction and segregation those positions and assets are bankruptcy remote in the event of the default or insolvency of the clearing member or one or more of its other clients;

(b) laws, regulations, rules and contractual arrangements applicable to or binding that institution or the CCP facilitate the transfer of the client's positions relating to those contracts and transactions and of the corresponding collateral to another clearing member within the applicable margin period of risk in the event of default or insolvency of the original clearing member. In such circumstance, the client's positions and the collateral must be transferred at market value unless the client requests to close out the position at market value;

(c) the client has conducted a sufficiently thorough legal review, which it has kept up to date, that substantiates that the arrangements that ensure that the condition set out in sub-paragraph (b) is met are legal, valid, binding and enforceable under the relevant laws of the relevant jurisdiction or jurisdictions;

(d) the CCP is a QCCP.

When assessing its compliance with the condition set out in sub-paragraph (b), an institution may take into account any clear precedents of transfers of client positions and of corresponding collateral at a CCP, and any industry intent to continue with that practice.

(3) By way of derogation from paragraph (2), where an institution that is a client fails to meet the condition set out in sub-paragraph (a) of that paragraph because that institution is not protected from losses in case the clearing member and another client of the clearing member jointly default, if all the other conditions set out in sub-paragraphs (a) to (d) of that paragraph are met, the institution may calculate the own funds requirements for its trade exposures for CCP-related transactions with its clearing member in accordance with Article 306, subject to replacing the 2% risk weight set out in Article 306(1)(a) with a 4% risk weight.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(4) In the case of a multi-level client structure, an institution that is a lower-level client accessing the services of a CCP through a higher-level client may apply the treatment set out in paragraph (2) or (3) only where the conditions set out in paragraph (2) or (3) (as appropriate) are met at every level of that structure.

Own funds requirements for trade exposures.

306.(1) An institution must apply the following treatment to its trade exposures with CCPs–

(a) it must apply a risk weight of 2% to the exposure values of all its trade exposures with QCCPs;

(b) it must apply the risk weight used for the Standardised Approach to credit risk as set out in Article 107(2)(b) to all its trade exposures with non-qualifying CCPs;

(c) where an institution acts as a financial intermediary between a client and a CCP, and the terms of the CCP-related transaction stipulate that the institution is not required to reimburse the client for any losses suffered due to changes in the value of that transaction in the event that the CCP defaults, that institution may set the exposure value of the trade exposure with the CCP that corresponds to that CCP-related transaction to zero;

(d) where an institution acts as a financial intermediary between a client and a CCP, and the terms of the CCP-related transaction stipulate that the institution is required to reimburse the client for any losses suffered due to changes in the value of that transaction in the event that the CCP defaults, that institution must apply the treatment in sub-paragraphs (a) or (b), as applicable, to the trade exposure with the CCP that corresponds to that CCP-related transaction.

(2) By way of derogation from paragraph (1), where assets posted as collateral to a CCP or a clearing member are bankruptcy remote in the event that the CCP, the clearing member or one or more of the other clients of the clearing member become insolvent, an institution may attribute an exposure value of zero to the counterparty credit risk exposures for those assets.

(3) An institution must calculate exposure values of its trade exposures with a CCP in accordance with Articles 218 to 236 and 271 to 299, as applicable.

(4) An institution must calculate the risk-weighted exposure amounts for its trade exposures with CCPs for the purposes of Article 92(3) as the sum of the exposure values of its trade exposures with CCPs, calculated in accordance with paragraphs (2) and (3), multiplied by the risk weight determined in accordance with paragraph (1).

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Own funds requirements for contributions to the default fund of a CCP.

307. An institution that acts as a clearing member must apply the following treatment to its exposures arising from its contributions to the default fund of a CCP–

(a) it must calculate the own funds requirement for its pre-funded contributions to the default fund of a QCCP in accordance with the approach set out in Article 308;

(b) it must calculate the own funds requirement for its pre-funded and unfunded contributions to the default fund of a non-qualifying CCP in accordance with the approach set out in Article 309;

(c) it must calculate the own funds requirement for its unfunded contributions to the default fund of a QCCP in accordance with the treatment set out in Article 310.

Own funds requirements for pre-funded contributions to the default fund of a QCCP.

308.(1) The exposure value for an institution's pre-funded contribution to the default fund of a QCCP (DFi) must be the amount paid in or the market value of the assets delivered by that institution reduced by any amount of that contribution that the QCCP has already used to absorb its losses following the default of one or more of its clearing members.

(2) An institution must calculate the own funds requirement to cover the exposure arising from its pre-funded contribution as follows–

$$K_i = \max\left\{K_{CCP} \cdot \frac{DF_i}{DF_{CCP} + DF_{CM}}, 8\% \cdot 2\% \cdot DF_i\right\}$$

where–

Ki = the own funds requirement;

i = the index denoting the clearing member;

KCCP = the hypothetical capital of the QCCP communicated to the institution by the QCCP in accordance with Article 50c of EMIR;

DFi = the pre-funded contribution;

DFCCP = the pre-funded financial resources of the CCP communicated to the institution by the CCP in accordance with Article 50c of EMIR; and

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

DFCM = the sum of pre-funded contributions of all clearing members of the QCCP communicated to the institution by the QCCP in accordance with Article 50c of EMIR.

(3) An institution must calculate the risk-weighted exposure amounts for exposures arising from that institution's pre-funded contribution to the default fund of a QCCP for the purposes of Article 92(3) as the own funds requirement, calculated in accordance with paragraph (2), multiplied by 12.5.

Own funds requirements for pre-funded contributions to the default fund of a non-qualifying CCP and for unfunded contributions to a non-qualifying CCP.

309.(1) An institution must apply the following formula to calculate the own funds requirement for the exposures arising from its pre-funded contributions to the default fund of a non-qualifying CCP and from unfunded contributions to such CCP–

$$K = DF + UC$$

where–

K = the own funds requirement;

DF = the pre-funded contributions to the default fund of a non-qualifying CCP; and

UC = the unfunded contributions to the default fund of a non-qualifying CCP.

(2) An institution must calculate the risk-weighted exposure amounts for exposures arising from that institution’s contribution to the default fund of a non-qualifying CCP for the purposes of Article 92(3) as the own funds requirement, calculated in accordance with paragraph (1), multiplied by 12.5.

Own funds requirements for unfunded contributions to the default fund of a QCCP.

310. An institution must apply a 0% risk weight to its unfunded contributions to the default fund of a QCCP.

Own funds requirements for exposures to CCPs that cease to meet certain conditions.

311.(1) Institutions must apply the treatment set out in this Article where it has become known to them, following a public announcement or notification from the competent authority of a

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

CCP used by those institutions or from that CCP itself, that the CCP will no longer comply with the conditions for authorisation or recognition, as applicable.

(2) Where the condition set out in paragraph (1) is met, institutions must, within three months of becoming aware of those circumstances, do the following with respect to their exposures to that CCP–

(a) apply the treatment set out in Article 306(1)(b) to their trade exposures to that CCP;

(b) apply the treatment set out in Article 309 to their pre-funded contributions to the default fund of that CCP and to its unfunded contributions to that CCP;

(c) treat their exposures to that CCP, other than the exposures listed in sub-paragraphs (a) and (b), as exposures to a corporate in accordance with the Standardised Approach for credit risk set out in Chapter 2.

TITLE 3
OWN FUNDS REQUIREMENTS FOR OPERATIONAL RISK

CHAPTER 1
GENERAL PRINCIPLES GOVERNING THE USE OF THE DIFFERENT APPROACHES

Approval and notification.

312.(1) To qualify for use of the Standardised Approach, institutions must meet the criteria set out in Article 320, in addition to meeting the general risk management standards set out in regulations 31 and 42 of the CICR Regulations. Institutions must notify the GFSC prior to using the Standardised Approach.

The GFSC may permit institutions to use an alternative relevant indicator for the business lines of retail banking and commercial banking where the conditions set out in Articles 319(2) and 320 are met.

(2) The GFSC may approve the use of Advanced Measurement Approaches by institutions based on their own operational risk measurement systems, where all the qualitative and quantitative standards set out in Articles 321 and 322 respectively are met and where institutions meet the general risk management standards set out in regulations 31, 42 and 74 to 81 of the CICR Regulations.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Institutions must also apply for GFSC approval where they want to implement material extensions and changes to those Advanced Measurement Approaches. The GFSC must consider whether the institution would continue to meet the standards specified in the first sub-paragraph following those material extensions and changes.

(3) Institutions must notify the GFSC of all changes to their Advanced Measurement Approaches models.

(4) [Not used]

Reverting to the use of less sophisticated approaches.

313.(1) Institutions that use the Standardised Approach must not revert to the use of the Basic Indicator Approach unless the conditions in paragraph (3) are met.

(2) Institutions that use the Advanced Measurement Approaches must not revert to the use of the Standardised Approach or the Basic Indicator Approach unless the conditions in paragraph (3) are met.

(3) An institution may only revert to the use of a less sophisticated approach for operational risk where both the following conditions are met–

(a) the institution has demonstrated to the satisfaction of the competent authority that the use of a less sophisticated approach is not proposed in order to reduce the operational risk related own funds requirements of the institution, is necessary on the basis of nature and complexity of the institution and would not have a material adverse impact on the solvency of the institution or its ability to manage operational risk effectively;

(b) the institution has received GFSC approval.

Combined use of different approaches.

314.(1) Institutions may use a combination of approaches if they obtain GFSC approval. The GFSC must consider whether the requirements set out in paragraphs (2) to (4), as applicable, are met.

(2) An institution may use an Advanced Measurement Approach in combination with either the Basic Indicator Approach or the Standardised Approach, where both of the following conditions are met–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) the combination of Approaches used by the institution captures all its operational risks and the GFSC is satisfied with the methodology used by the institution to cover different activities, geographical locations, legal structures or other relevant divisions determined on an internal basis;

(b) the criteria set out in Article 320 and the standards set out in Articles 321 and 322 are fulfilled for the part of activities covered by the Standardised Approach and the Advanced Measurement Approaches respectively.

(3) For institutions that want to use an Advanced Measurement Approach in combination with either the Basic Indicator Approach or the Standardised Approach the GFSC may impose the following additional conditions for granting approval–

(a) on the date of implementation of an Advanced Measurement Approach, a significant part of the institution's operational risks are captured by that Approach;

(b) the institution takes a commitment to apply the Advanced Measurement Approach across a material part of its operations within a time schedule that was submitted to and approved by the GFSC.

(4) An institution may request GFSC approval to use a combination of the Basic Indicator Approach and the Standardised Approach only in exceptional circumstances such as the recent acquisition of new business which may require a transitional period for the application of the Standardised Approach.

The GFSC must consider whether the institution has committed to apply the Standardised Approach within a time schedule that was submitted to and approved by the GFSC.

(5) [Not used]

CHAPTER 2
BASIC INDICATOR APPROACH

Own funds requirement.

315.(1) Under the Basic Indicator Approach, the own funds requirement for operational risk is equal to 15% of the average over three years of the relevant indicator as set out in Article 316.

Institutions must calculate the average over three years of the relevant indicator on the basis of the last three twelve-monthly observations at the end of the financial year. When audited figures are not available, institutions may use business estimates.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(2) Where an institution has been in operation for less than three years it may use forward-looking business estimates in calculating the relevant indicator if it starts using historical data as soon as it is available.

(3) Where an institution can prove to the GFSC that, due to a merger, an acquisition or a disposal of entities or activities, using a three year average to calculate the relevant indicator would lead to a biased estimation for the own funds requirement for operational risk, the GFSC may permit the institution to amend the calculation in a way that would take into account such events. In such circumstances, the GFSC may, on its own initiative, also require an institution to amend the calculation.

(4) Where for any given observation, the relevant indicator is negative or equal to zero, institutions must not take into account this figure in the calculation of the average over three years. Institutions must calculate the average over three years as the sum of positive figures divided by the number of positive figures.

Relevant indicator.

316.(1) For institutions using the vertical format of profit and loss account in Chapter 4 of Part 2 of Schedule 1 to the Financial Services (Credit Institutions) (Accounts) Regulations 2021, the relevant indicator is the sum of the elements listed in Table 1 of this paragraph. Institutions must include each element in the sum with its positive or negative sign.

Table 1

1	Interest receivable and similar income
2	Interest payable and similar charges
3	Income from shares and other variable/fixed-yield securities
4	Commissions/fees receivable
5	Commissions/fees payable
6	Net profit or net loss on financial operations
7	Other operating income

Institutions must adjust these elements to reflect the following qualifications–

(a) institutions must calculate the relevant indicator before the deduction of any provisions and operating expenses. Institutions must include in operating expenses fees paid for outsourcing services rendered by third parties which are not a parent or subsidiary of the institution or a subsidiary of a parent which is also the parent of the institution. Institutions may use expenditure on the outsourcing of services rendered by third parties to reduce the relevant indicator where the expenditure is

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

incurred from an undertaking subject to rules under or equivalent to these Standards;

(b) institutions must not use the following elements in the calculation of the relevant indicator–

(i) realised profits/losses from the sale of non-trading book items;

(ii) income from extraordinary or irregular items;

(iii) income derived from insurance.

(c) when revaluation of trading items is part of the profit and loss statement, institutions may include revaluation. When institutions apply paragraph (20)(4) of Schedule 1 to the Financial Services (Credit Institutions) (Accounts) Regulations 2021, they must include revaluation booked in the profit and loss account.

By way of derogation from the first sub-paragraph, institutions may choose not to apply the accounting categories for the profit and loss account under Chapter 4 of Part 2 of Schedule 1 to the Financial Services (Credit Institutions) (Accounts) Regulations 2021 to financial and operating leases for the purpose of calculating the relevant indicator, and may instead–

(a) include interest income from financial and operating leases and profits from leased assets in the category referred to in point 1 of Table 1; and

(b) include interest expense from financial and operating leases, losses, depreciation and impairment of operating leased assets in the category referred to in point 2 of Table 1.

(2) When institutions apply accounting standards different from those in the Financial Services (Credit Institutions) (Accounts) Regulations 2021, they must calculate the relevant indicator on the basis of data that best reflect the definition set out in this Article.

(3) [Not used]

CHAPTER 3
STANDARDISED APPROACH

Own funds requirement.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

317.(1) Under the Standardised Approach, institutions must divide their activities into the business lines set out in Table 2 of paragraph (4) and in accordance with the principles set out in Article 318.

(2) Institutions must calculate the own funds requirement for operational risk as the average over three years of the sum of the annual own funds requirements across all business lines referred to in Table 2 of paragraph (4). The annual own funds requirement of each business line is equal to the product of the corresponding beta factor referred to in that Table and the part of the relevant indicator mapped to the respective business line.

(3) In any given year, institutions may offset negative own funds requirements resulting from a negative part of the relevant indicator in any business line with positive own funds requirements in other business lines without limit. However, where the aggregate own funds requirement across all business lines within a given year is negative, institutions must use the value zero as the input to the numerator for that year.

(4) Institutions must calculate the average over three years of the sum referred to in paragraph (2) on the basis of the last three twelve-monthly observations at the end of the financial year. When audited figures are not available, institutions may use business estimates.

Where an institution can prove to the GFSC that, due to a merger, an acquisition or a disposal of entities or activities, using a three year average to calculate the relevant indicator would lead to a biased estimation for the own funds requirement for operational risk, the GFSC may permit institutions to amend the calculation in a way that would take into account such events. In such circumstances, the GFSC may, on its own initiative, also require an institution to amend the calculation.

Where an institution has been in operation for less than three years it may use forward-looking business estimates in calculating the relevant indicator if it starts using historical data as soon as it is available.

Table 2

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Business line	List of activities	Percentage (beta factor)
Corporate finance	Underwriting of financial instruments or placing of financial instruments on a firm commitment basis Services related to underwriting Investment advice Advice to undertakings on capital structure, industrial strategy and related matters and advice and services relating to the mergers and the purchase of undertakings Investment research and financial analysis and other forms of general recommendation relating to transactions in financial instruments	18 %
Trading and sales	Dealing on own account Money broking Reception and transmission of orders in relation to one or more financial instruments Execution of orders on behalf of clients Placing of financial instruments without a firm commitment basis Operation of Multilateral Trading Facilities	18 %
Retail brokerage (Activities with natural persons or with SMEs meeting the criteria set out in Article 123 for the retail exposure class)	Reception and transmission of orders in relation to one or more financial instruments Execution of orders on behalf of clients Placing of financial instruments without a firm commitment basis	12 %
Commercial banking	Acceptance of deposits and other repayable funds Lending Financial leasing Guarantees and commitments	15 %
Retail banking (Activities with natural persons or with SMEs meeting the criteria set out in Article 123 for the retail exposure class)	Acceptance of deposits and other repayable funds Lending Financial leasing Guarantees and commitments	12 %
Payment and settlement	Money transmission services, Issuing and administering means of payment	18 %
Agency services	Safekeeping and administration of financial instruments for the account of clients, including custodianship and related services such as cash/collateral management	15 %
Asset management	Portfolio management Managing of UCITS Other forms of asset management	12 %

Principles for business line mapping.

318.(1) Institutions must develop and document specific policies and criteria for mapping the relevant indicator for current business lines and activities into the standardised framework set out in Article 317. They must review and adjust those policies and criteria as appropriate for new or changing business activities and risks.

(2) Institutions must apply the following principles for business line mapping–

(a) institutions must map all activities into the business lines in a mutually exclusive and jointly exhaustive manner;

(b) institutions must allocate any activity which cannot be readily mapped into the business line framework, but which represents an ancillary activity to an activity included in the framework, to the business line it supports. Where more than one business line is supported through the ancillary activity, institutions must use an objective-mapping criterion;

(c) where an activity cannot be mapped into a particular business line then institutions must use the business line yielding the highest percentage. The same business line equally applies to any ancillary activity associated with that activity;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(d) institutions may use internal pricing methods to allocate the relevant indicator between business lines. Costs generated in one business line which are imputable to a different business line may be reallocated to the business line to which they pertain;

(e) the mapping of activities into business lines for operational risk capital purposes must be consistent with the categories institutions use for credit and market risks;

(f) senior management must be responsible for the mapping policy under the control of the management body of the institution;

(g) institutions must subject the mapping process to business lines to independent review.

(3) [Not used]

Alternative Standardised Approach.

319.(1) Under the Alternative Standardised Approach, for the business lines ‘retail banking’ and ‘commercial banking’ , institutions must apply the following–

(a) the relevant indicator is a normalised income indicator equal to the nominal amount of loans and advances multiplied by 0.035;

(b) the loans and advances consist of the total drawn amounts in the corresponding credit portfolios. For the “commercial banking” business line, institutions must also include securities held in the non-trading book in the nominal amount of loans and advances.

(2) To be permitted to use the Alternative Standardised Approach, an institution must meet all the following conditions–

(a) its retail or commercial banking activities must account for at least 90% of its income;

(b) a significant proportion of its retail or commercial banking activities must comprise loans associated with a high PD;

(c) the Alternative Standardised Approach provides an appropriate basis for calculating its own funds requirement for operational risk.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Criteria for the Standardised Approach.

320. The criteria referred to in the first sub-paragraph of Article 312(1) are the following–

(a) an institution must have in place a well-documented assessment and management system for operational risk with clear responsibilities assigned for this system. It must identify its exposures to operational risk and track relevant operational risk data, including material loss data. This system must be subject to regular independent review carried out by an internal or external party possessing the necessary knowledge to carry out such review;

(b) an institution's operational risk assessment system must be closely integrated into the risk management processes of the institution. Its output must be an integral part of the process of monitoring and controlling the institution's operational risk profile;

(c) an institution must implement a system of reporting to senior management that provides operational risk reports to relevant functions within the institution. An institution must have in place procedures for taking appropriate action according to the information within the reports to management.

CHAPTER 4
ADVANCED MEASUREMENT APPROACHES

Qualitative standards.

321. The qualitative standards referred to in Article 312(2) are the following–

(a) an institution's internal operational risk measurement system must be closely integrated into its day-to-day risk management processes;

(b) an institution must have an independent risk management function for operational risk;

(c) an institution must have in place regular reporting of operational risk exposures and loss experience and must have in place procedures for taking appropriate corrective action;

(d) an institution's risk management system must be well documented. An institution must have in place routines for ensuring compliance and policies for the treatment of non-compliance;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(e) an institution must subject its operational risk management processes and measurement systems to regular reviews performed by internal or external auditors;

(f) an institution's internal validation processes must operate in a sound and effective manner;

(g) data flows and processes associated with an institution's risk measurement system must be transparent and accessible.

Quantitative Standards.

322.(1) The quantitative standards referred to in Article 312(2) include the standards relating to process, to internal data, to external data, to scenario analysis, to business environment and to internal control factors laid down in paragraphs (2) to (6) respectively.

(2) The standards relating to process are the following–

(a) an institution must calculate its own funds requirement as comprising both expected loss and unexpected loss, unless expected loss is adequately captured in its internal business practices. The operational risk measure must capture potentially severe tail events, achieving a soundness standard comparable to a 99.9% confidence interval over a one year period;

(b) an institution's operational risk measurement system must include the use of internal data, external data, scenario analysis and factors reflecting the business environment and internal control systems as set out in paragraphs (3) to (6). An institution must have in place a well documented approach for weighting the use of these four elements in its overall operational risk measurement system;

(c) an institution's risk measurement system must capture the major drivers of risk affecting the shape of the tail of the estimated distribution of losses;

(d) an institution may recognise correlations in operational risk losses across individual operational risk estimates only where its systems for measuring correlations are sound, implemented with integrity, and take into account the uncertainty surrounding any such correlation estimates, particularly in periods of stress. An institution must validate its correlation assumptions using appropriate quantitative and qualitative techniques;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(e) an institution's risk measurement system must be internally consistent and must avoid the multiple counting of qualitative assessments or risk mitigation techniques recognised in other areas of these Standards.

(3) The standards relating to internal data are the following–

(a) an institution must base its internally generated operational risk measures on a minimum historical observation period of five years. When an institution first moves to an Advanced Measurement Approach, it may use a three-year historical observation period;

(b) an institution must be able to map their historical internal loss data into the business lines defined in Article 317 and into the event types defined in Article 324, and to provide these data to GFSC upon request. In exceptional circumstances, an institution may allocate loss events which affect the entire institution to an additional business line "corporate items". An institution must have in place documented, objective criteria for allocating losses to the specified business lines and event types. An institution must record the operational risk losses that are related to credit risk and that the institution has historically included in the internal credit risk databases in the operational risk databases and must identify them separately. Such losses are not subject to the operational risk charge, if the institution is required to continue to treat them as credit risk for the purposes of calculating own funds requirements. An institution must include operational risk losses that are related to market risks in the scope of the own funds requirement for operational risk;

(c) an institution's internal loss data must be comprehensive in that it captures all material activities and exposures from all appropriate sub-systems and geographic locations. An institution must be able to justify that any excluded activities or exposures, both individually and in combination, would not have a material impact on the overall risk estimates. An institution must define appropriate minimum loss thresholds for internal loss data collection;

(d) aside from information on gross loss amounts, an institution must collect information about the date of the loss event, any recoveries of gross loss amounts, as well as descriptive information about the drivers or causes of the loss event;

(e) an institution must have in place specific criteria for assigning loss data arising from a loss event in a centralised function or an activity that spans more than one business line, as well as from related loss events over time;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(f) an institution must have in place documented procedures for assessing the on-going relevance of historical loss data, including those situations in which judgement overrides, scaling, or other adjustments may be used, to what extent they may be used and who is authorised to make such decisions.

(4) The qualifying standards relating to external data are the following–

(a) an institution's operational risk measurement system must use relevant external data, especially when there is reason to believe that the institution is exposed to infrequent, yet potentially severe, losses. An institution must have a systematic process for determining the situations for which external data must be used and the methodologies used to incorporate the data in its measurement system;

(b) an institution must regularly review the conditions and practices for external data and must document them and subject them to periodic independent review.

(5) An institution must use scenario analysis of expert opinion in conjunction with external data to evaluate its exposure to high severity events. Over time, the institution must validate and reassess such assessments through comparison to actual loss experience to ensure their reasonableness.

(6) The qualifying standards relating to business environment and internal control factors are the following–

(a) an institution's firm-wide risk assessment methodology must capture key business environment and internal control factors that can change the institutions operational risk profile;

(b) an institution must justify the choice of each factor as a meaningful driver of risk, based on experience and involving the expert judgment of the affected business areas;

(c) an institution must be able to justify to GFSC the sensitivity of risk estimates to changes in the factors and the relative weighting of the various factors. In addition to capturing changes in risk due to improvements in risk controls, an institution's risk measurement framework must also capture potential increases in risk due to greater complexity of activities or increased business volume;

(d) an institution must document its risk measurement framework and must subject it to independent review within the institution and by GFSC. Over time, an institution must validate and reassess the process and the outcomes through comparison to actual internal loss experience and relevant external data.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Impact of insurance and other risk transfer mechanisms.

323.(1) The GFSC may permit institutions to recognise the impact of insurance subject to the conditions set out in paragraphs (2) to (5) and other risk transfer mechanisms where the institution can demonstrate that a noticeable risk mitigating effect is achieved.

(2) The insurance provider must be authorised to provide insurance or re-insurance and must have a minimum claims paying ability rating by an ECAI which has been determined by the GFSC to be associated with credit quality step 3 or above under the rules for the risk weighting of exposures to institutions under Title 2, Chapter 2.

(3) The insurance and the institutions' insurance framework must meet all the following conditions–

(a) the insurance policy has an initial term of no less than one year. For policies with a residual term of less than one year, an institution must make appropriate haircuts reflecting the declining residual term of the policy, up to a full 100% haircut for policies with a residual term of 90 days or less;

(b) the insurance policy has a minimum notice period for cancellation of the contract of 90 days;

(c) the insurance policy has no exclusions or limitations triggered by supervisory actions or, in the case of a failed institution, that preclude the institution's receiver or liquidator from recovering the damages suffered or expenses incurred by the institution, except in respect of events occurring after the initiation of receivership or liquidation proceedings in respect of the institution. However, the insurance policy may exclude any fine, penalty, or punitive damages resulting from actions by the GFSC;

(d) the risk mitigation calculations must reflect the insurance coverage in a manner that is transparent in its relationship to, and consistent with, the actual likelihood and impact of loss used in the overall determination of operational risk capital;

(e) the insurance is provided by a third party entity. In the case of insurance through captives and affiliates, the exposure has to be laid off to an independent third party entity that meets the eligibility criteria set out in paragraph (2);

(f) the framework for recognising insurance is well reasoned and documented.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(4) The methodology for recognising insurance must capture all the following elements through discounts or haircuts in the amount of insurance recognition–

(a) the residual term of the insurance policy, where less than one year;

(b) the policy's cancellation terms, where less than one year;

(c) the uncertainty of payment as well as mismatches in coverage of insurance policies.

(5) The reduction in own funds requirements from the recognition of insurances and other risk transfer mechanisms must not exceed 20% of the own funds requirement for operational risk before the recognition of risk mitigation techniques.

Loss event type classification.

324. The loss events types referred to in Article 322(3)(b) are the following–

Table 3

Event-Type Category	Definition
Internal fraud	Losses due to acts of a type intended to defraud, misappropriate property or circumvent regulations, the law or company policy, excluding diversity/discrimination events, which involves at least one internal party
External fraud	Losses due to acts of a type intended to defraud, misappropriate property or circumvent the law, by a third party
Employment Practices and Workplace Safety	Losses arising from acts inconsistent with employment, health or safety laws or agreements, from payment of personal injury claims, or from diversity/discrimination events
Clients, Products & Business Practices	Losses arising from an unintentional or negligent failure to meet a professional obligation to specific clients (including fiduciary and suitability requirements), or from the nature or design of a product
Damage to Physical Assets	Losses arising from loss or damage to physical assets from natural disaster or other events
Business disruption and system failures	Losses arising from disruption of business or system failures
Execution, Delivery & Process Management	Losses from failed transaction processing or process management, from relations with trade counterparties and vendors

TITLE 4
OWN FUNDS REQUIREMENTS FOR MARKET RISK

CHAPTER 1
GENERAL PROVISIONS

Approaches for calculating the own funds requirements for market risk.

325.(1) An institution must calculate the own funds requirements for market risk of all trading book positions and non-trading book positions that are subject to foreign exchange risk or commodity risk in accordance with the following approaches–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) the standardised approach referred to in paragraph (2);

(b) the internal model approach set out in Chapter 5 of this Title for those risk categories for which the institution has been granted approval in accordance with Article 363 to use that approach.

(2) The own funds requirements for market risk calculated in accordance with the standardised approach referred to in paragraph (1)(a) must mean the sum of the following own funds requirements, as applicable–

(a) the own funds requirements for position risk referred to in Chapter 2;

(b) the own funds requirements for foreign exchange risk referred to in Chapter 3;

(c) the own funds requirements for commodity risk referred to in Chapter 4.

(3) An institution that is not exempted from the reporting requirements set out in Article 430B in accordance with Article 325A must report the calculation in accordance with Article 430B for all trading book positions and non-trading book positions that are subject to foreign exchange risk or commodity risk in accordance with the following approaches–

(a) the alternative standardised approach set out in Chapter 1A;

(b) the alternative internal model approach set out in Chapter 1B.

(4) An institution may use in combination the approaches set out in paragraph (1)(a) and (b) on a permanent basis within a group in accordance with Article 363.

(5) Institutions must not use the approach set out in paragraph (3)(b) for instruments in their trading book that are securitisation positions or positions included in the alternative correlation trading portfolio (ACTP) as set out in paragraphs (6), (7) and (8).

(6) Securitisation positions and nth-to-default credit derivatives that meet all the following criteria must be included in the ACTP–

(a) the positions are neither re-securitisation positions, nor options on a securitisation tranche, nor any other derivatives of securitisation exposures that do not provide a pro-rata share in the proceeds of a securitisation tranche;

(b) all their underlying instruments are–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(i) single-name instruments, including single-name credit derivatives, for which a liquid two-way market exists;

(ii) commonly-traded indices based on the instruments referred to in paragraph (i).

A two-way market is considered to exist where there are independent bona fide offers to buy and sell, so that a price that is reasonably related to the last sales price or current bona fide competitive bid and offer quotations can be determined within one day and settled at that price within a relatively short time conforming to trade custom.

(7) Positions with any of the following underlying instruments must not be included in the ACTP–

(a) underlying instruments that are assigned to the exposure classes referred to in Article 112(h) or (i);

(b) a claim on a special purpose entity, collateralised, directly or indirectly, by a position that, in accordance with paragraph (6), would itself not be eligible for inclusion in the ACTP.

(8) Institutions may include in the ACTP positions that are neither securitisation positions nor nth-to-default credit derivatives but that hedge other positions in that portfolio, if a liquid two-way market as described in the second sub-paragraph of paragraph (6) exists for the instrument or its underlying instruments.

(9) [Not used]

Exemptions from specific reporting requirements for market risk.

325A.(1) An institution must be exempted from the reporting requirement set out in Article 430B, if the size of the institution's on- and off-balance-sheet business that is subject to market risk is equal to or less than each of the following thresholds, on the basis of an assessment carried out on a monthly basis using data as of the last day of the month–

(a) 10% of the institution's total assets;

(b) €500 million.

(2) Institutions must calculate the size of their on- and off-balance-sheet business that is subject to market risk using data as of the last day of each month in accordance with the following requirements–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) all the positions assigned to the trading book must be included, except credit derivatives that are recognised as internal hedges against non-trading book credit risk exposures and the credit derivative transactions that perfectly offset the market risk of the internal hedges as referred to in Article 106(3);

(b) all non-trading book positions that are subject to foreign exchange risk or commodity risk must be included;

(c) all positions must be valued at their market values on that date, except for positions referred to in sub-paragraph (b); where the market value of a position is not available on a given date, institutions must take a fair value for the position on that date; where the fair value and market value of a position are not available on a given date, institutions must take the most recent market value or fair value for that position;

(d) all non-trading book positions that are subject to foreign exchange risk are considered as an overall net foreign exchange position and valued in accordance with Article 352;

(e) all the non-trading book positions that are subject to commodity risk are valued in accordance with Articles 357 and 358;

(f) the absolute value of long positions are added to the absolute value of short positions.

(3) Institutions must notify the GFSC when they calculate, or cease to calculate, their own funds requirements for market risk in accordance with this Article.

(4) An institution that no longer meets one or more of the conditions set out in paragraph (1) must immediately notify the GFSC thereof.

(5) The exemption from the reporting requirements laid down in Article 430B must cease to apply within three months of either of the following cases–

(a) the institution does not meet the condition set out in paragraph (1)(a) or (b) for three consecutive months; or

(b) the institution does not meet the condition set out in paragraph (1)(a) or (b) during more than 6 out of the last 12 months.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(6) Where an institution has become subject to the reporting requirements laid down in Article 430B in accordance with paragraph (5), the institution must only be exempted from those reporting requirements where it demonstrates to the GFSC that all the conditions set out in paragraph (1) have been met for an uninterrupted full-year period.

(7) Institutions must not enter into, buy or sell a position only for the purpose of complying with any of the conditions set out in paragraph (1) during the monthly assessment.

(8) An institution that is eligible for the treatment set out in Article 94 must be exempted from the reporting requirement set out in Article 430B.

Approval for consolidated requirements.

325B.(1) Subject to paragraph (2), and only for the purpose of calculating net positions and own funds requirements in accordance with this Title on a consolidated basis, institutions may use positions in one institution or undertaking to offset positions in another institution or undertaking.

(2) Institutions may apply paragraph (1) only with GFSC approval which must be granted if all the following conditions are met–

(a) there is a satisfactory allocation of own funds within the group;

(b) the regulatory, legal or contractual framework in which the institutions operate guarantees mutual financial support within the group.

(3) Where there are undertakings located in third countries, all the following conditions must be met in addition to those set out in paragraph (2)–

(a) such undertakings have been authorised in a third country and either satisfy the definition of a credit institution or are recognised third-country investment firms;

(b) on an individual basis, such undertakings comply with own funds requirements equivalent to those laid down in these Standards;

(c) no regulations exist in the third countries in question which might significantly affect the transfer of funds within the group.

CHAPTER 1A
ALTERNATIVE STANDARDISED APPROACH

General provisions

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Scope and structure of the alternative standardised approach.

325C.(1) The alternative standardised approach as set out in this Chapter must be used only for the purposes of the reporting requirement laid down in Article 430B(1).

(2) Institutions must calculate the own funds requirements for market risk in accordance with the alternative standardised approach for a portfolio of trading book positions or non-trading book positions that are subject to foreign exchange or commodity risk as the sum of the following three components–

(a) the own funds requirement under the sensitivities-based method set out in Articles 325D to 325K;

(b) the own funds requirement for the default risk set out in Article 325V which is only applicable to the trading book positions referred to in that Article;

(c) the own funds requirement for residual risks set out in Article 325U which is only applicable to the trading book positions referred to in that Article.

Sensitivities-based method for calculating the own funds requirements

Definitions.

325D. For the purposes of this Chapter, the following definitions apply–

"risk class" means one of the following seven categories–

(a) general interest rate risk;

(b) credit spread risk (CSR) for non-securitisation;

(c) credit spread risk for securitisation not included in the alternative correlation trading portfolio (non-ACTP CSR);

(d) credit spread risk for securitisation included in the alternative correlation trading portfolio (ACTP CSR);

(e) equity risk;

(f) commodity risk;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(g) foreign exchange risk;

“bucket” means a sub-category of positions within one risk class with a similar risk profile to which a risk weight as defined in is assigned;

“sensitivity” means the relative change in the value of a position, as a result of a change in the value of one of the relevant risk factors of the position, calculated with the institution's pricing model in accordance with Articles 325R to 325T.

Components of the sensitivities-based method.

325E.(1) Institutions must calculate the own funds requirement for market risk under the sensitivities-based method by aggregating the following three own funds requirements in accordance with Article 325H–

(a) own funds requirements for delta risk which capture the risk of changes in the value of an instrument due to movements in its non-volatility related risk factors;

(b) own funds requirements for vega risk which capture the risk of changes in the value of an instrument due to movements in its volatility-related risk factors;

(c) own funds requirements for curvature risk which capture the risk of changes in the value of an instrument due to movements in the main non-volatility related risk factors not captured by the own funds requirements for delta risk.

(2) For the purpose of the calculation referred to in paragraph (1)–

(a) all the positions of instruments with optionality must be subject to the own funds requirements referred to in paragraph (1)(a), (b) and (c);

(b) all the positions of instruments without optionality must only be subject to the own funds requirements referred to in paragraph (1)(a).

For the purposes of this Chapter, instruments with optionality include, among others– calls, puts, caps, floors, swap options, barrier options and exotic options. Embedded options, such as prepayment or behavioural options, are considered to be stand-alone positions in options for the purpose of calculating the own funds requirements for market risk.

For the purposes of this Chapter, instruments whose cash flows can be written as a linear function of the underlying's notional amount are considered to be instruments without optionality.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Own funds requirements for delta and vega risks.

325F.(1) Institutions must apply the delta and vega risk factors described in Articles 325L to 325Q to calculate the own funds requirements for delta and vega risks.

(2) Institutions must apply the process set out in paragraphs (3) to (8) to calculate own funds requirements for delta and vega risks.

(3) For each risk class, the sensitivity of all instruments in scope of the own funds requirements for delta or vega risks to each of the applicable delta or vega risk factors included in that risk class must be calculated by using the corresponding formulas in Articles 325R to 325T. If the value of an instrument depends on several risk factors, the sensitivity is determined separately for each risk factor.

(4) Sensitivities are assigned to one of the buckets “b” within each risk class.

(5) Within each bucket “b”, the positive and negative sensitivities to the same risk factor must be netted, giving rise to net sensitivities (s_k) to each risk factor k within a bucket.

(6) The net sensitivities to each risk factor within each bucket are multiplied by the corresponding risk weights set out in Articles 325AE to 325AY, giving rise to weighted sensitivities to each risk factor within that bucket in accordance with the following formula–

$$WS_k = RW_k \cdot s_k$$

where–

WS_k = the weighted sensitivities;

RW_k = the risk weights; and

s_k = the risk factor.

(7) The weighted sensitivities to the different risk factors within each bucket are aggregated in accordance with the formula below, where the quantity within the square root function is floored at zero, giving rise to the bucket-specific sensitivity. The corresponding correlations for weighted sensitivities within the same bucket (ρ_{kl}), set out in Articles 325AE to 325AY, must be used.

$$K_b = \sqrt{\sum_k WS_k^2 + \sum_k \sum_{k \neq l} \rho_{kl} WS_k WS_l}$$

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

where–

K_b = the bucket-specific sensitivity; and

WS = the weighted sensitivities.

(8) The bucket-specific sensitivity is calculated for each bucket within a risk class in accordance with paragraphs (5), (6) and (7). Once the bucket-specific sensitivity has been calculated for all buckets, weighted sensitivities to all risk factors across buckets are aggregated in accordance with the formula below, using the corresponding correlations γ_{bc} for weighted sensitivities in different buckets set out in Articles 325AE to 325AY, giving rise to the risk-class specific own funds requirement for delta or vega risk–

$$\text{Risk} - \text{class specific own funds requirement for delta or vega risk} = \sqrt{\sum_b K_b^2 + \sum_b \sum_{c \neq b} \gamma_{bc} S_b S_c}$$

where–

$S_b = \Sigma_k WS_k$ for all risk factors in bucket b and $S_c = \Sigma_k WS_k$ in bucket c; where those values for S_b and S_c produce a negative number for the overall sum of

$$\sum_b K_b^2 + \sum_b \sum_c \neq b \, \gamma_{bc} S_b S_c$$

, the institution must calculate the risk-class specific own funds requirements for delta or vega risk using an alternative specification whereby

$S_b = \max [\min (\Sigma_k WS_k , K_b), - K_b]$ for all risk factors in bucket b and

$S_c = \max [\min (\Sigma_k WS_k , K_c), - K_c]$ for all risk factors in bucket c.

The risk-class specific own funds requirements for delta or vega risk are calculated for each risk class in accordance with paragraphs (1) to (8).

Own funds requirements for curvature risk.

325G. Institutions must calculate the own funds requirements for curvature risk in accordance with the regulations referred to in Article 461A (to the extent it applies on and after 1st February 2026).

Aggregation of risk-class specific own funds requirements for delta, vega and curvature risks.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

325H.(1) Institutions must aggregate risk-class specific own funds requirements for delta, vega and curvature risks in accordance with the process set out in paragraphs (2), (3) and (4).

(2) The process to calculate the risk-class specific own funds requirements for delta, vega and curvature risks described in Articles 325F and 325G must be performed three times per risk class, each time using a different set of correlation parameters ρ kl (correlation between risk factors within a bucket) and γ bc (correlation between buckets within a risk class). Each of those three sets must correspond to a different scenario, as follows–

(a) the medium correlations scenario, whereby the correlation parameters ρ kl and γ bc remain unchanged from those specified in Articles 325AE to 325AY;

(b) the high correlations scenario, whereby the correlation parameters ρ kl and γ bc that are specified in Articles 325AE to 325AY must be uniformly multiplied by 1.25, with ρ kl and γ bc subject to a cap at 100%;

(c) the low correlations scenario are specified in the regulations referred to in Article (to the extent it applies on and after 1st February 2026).

(3) Institutions must calculate the sum of the delta, vega and curvature risk-class specific own funds requirements for each scenario to determine three scenario-specific, own funds requirements.

(4) The own funds requirement under the sensitivities-based method must be the highest of the three scenario-specific own funds requirements referred to in paragraph (3).

Treatment of index instruments and multi-underlying options.

325I. Institutions must treat the index instruments and multi-underlying options in accordance with the regulations referred to in Article 461A (to the extent it applies on and after 1st February 2026).

Treatment of collective investment undertakings.

325J. Institutions must treat the collective investment undertakings in accordance with the regulations referred to in Article 461A (to the extent it applies on and after 1st February 2026).

Underwriting positions.

325K.(1) Institutions may use the process set out in this Article for calculating the own funds requirements for market risk of underwriting positions of debt or equity instruments.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(2) Institutions must apply one of the appropriate multiplying factors listed in Table 1 to the net sensitivities of all the underwriting positions in each individual issuer, excluding the underwriting positions which are subscribed or sub-underwritten by third parties on the basis of formal agreements, and calculate the own funds requirements for market risk in accordance with the approach set out in this Chapter on the basis of the adjusted net sensitivities.

Table 1

Business day 0	0 %
Business day 1	10 %
Business days 2 and 3	25 %
Business day 4	50 %
Business day 5	75 %
After business day 5	100 %

For the purposes of this Article, "business day 0" means the business day on which the institution becomes unconditionally committed to accepting a known quantity of securities at an agreed price.

(3) Institutions must notify the GFSC of the application of the process set out in this Article.

Risk factor and sensitivity definitions

General interest rate risk factors.

325L.(1) For all general interest rate risk factors, including inflation risk and cross-currency basis risk, there must be one bucket per currency, each containing different types of risk factor.

The delta general interest rate risk factors applicable to interest rate-sensitive instruments must be the relevant risk-free rates per currency and per each of the following maturities– 0.25 years, 0.5 years, 1 year, 2 years, 3 years, 5 years, 10 years, 15 years, 20 years, 30 years. Institutions must assign risk factors to the specified vertices by linear interpolation or by using a method that is most consistent with the pricing functions used by the independent risk control function of the institution to report market risk or profits and losses to senior management.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(2) Institutions must obtain the risk-free rates per currency from money market instruments held in the trading book of the institution that have the lowest credit risk, such as overnight index swaps.

(3) Where institutions cannot apply the approach referred to in paragraph (2), the risk-free rates must be based on one or more market-implied swap curves used by the institution to mark positions to market, such as the interbank offered rate swap curves.

Where the data on market-implied swap curves described in paragraph (2) and the first sub-paragraph of this paragraph are insufficient, the risk-free rates may be derived from the most appropriate sovereign bond curve for a given currency.

Where institutions use the general interest rate risk factors derived in accordance with the procedure set out in the second sub-paragraph of this paragraph for sovereign debt instruments, the sovereign debt instrument are not exempted from the own funds requirements for credit spread risk. In those cases, where it is not possible to disentangle the risk-free rate from the credit spread component, the sensitivity to the risk factor is allocated to the general interest rate risk and to credit spread risk classes.

(4) In the case of general interest rate risk factors, each currency must constitute a separate bucket. Institutions must assign risk factors within the same bucket, but with different maturities, a different risk weight, in accordance with Articles 325AE to 325AY.

Institutions must apply additional risk factors for inflation risk to debt instruments whose cash flows are functionally dependent on inflation rates. Those additional risk factors must consist of one vector of market-implied inflation rates of different maturities per currency. For each instrument, the vector must contain as many components as there are inflation rates used as variables by the institution's pricing model for that instrument.

(5) Institutions must calculate the sensitivity of the instrument to the additional risk factor for inflation risk referred to in paragraph (4) as the change in the value of the instrument, according to its pricing model, as a result of a 1 basis point shift in each of the components of the vector. Each currency must constitute a separate bucket. Within each bucket, institutions must treat inflation as a single risk factor, regardless of the number of components of each vector. Institutions must offset all sensitivities to inflation within a bucket, calculated as described in this paragraph, in order to give rise to a single net sensitivity per bucket.

(6) Debt instruments that involve payments in different currencies are subject to cross-currency basis risk between those currencies. For the purposes of the sensitivities-based method, the risk factors to be applied by institutions are the cross-currency basis risk of each currency over either US dollar or euro. Institutions must compute cross currency bases that do

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

not relate to either basis over US dollar or basis over euro either on “basis over US dollar” or “basis over euro”.

Each cross-currency basis risk factor must consist of one vector of cross-currency basis of different maturities per currency. For each debt instrument, the vector must contain as many components as there are cross-currency bases used as variables by the institution's pricing model for that instrument. Each currency must constitute a different bucket.

Institutions must calculate the sensitivity of the instrument to the cross-currency basis risk factor as the change in the value of the instrument, according to its pricing model, as a result of a 1 basis point shift in each of the components of the vector. Each currency must constitute a separate bucket. Within each bucket there must be two possible distinct risk factors– basis over euro and basis over US dollar, regardless of the number of components there are in each cross-currency basis vector. The maximum number of net sensitivities per bucket must be two.

(7) The vega general interest rate risk factors applicable to options with underlyings that are sensitive to general interest rate must be the implied volatilities of the relevant risk-free rates as described in paragraphs (2) and (3), which must be assigned to buckets depending on the currency and mapped to the following maturities within each bucket– 0.5 years, 1 year, 3 years, 5 years, 10 years. There must be one bucket per currency.

For netting purposes, institutions must consider implied volatilities linked to the same risk-free rates and mapped to the same maturities to constitute the same risk factor.

Where institutions map implied volatilities to the maturities as referred to in this paragraph, the following requirements must apply–

(a) where the maturity of the option is aligned with the maturity of the underlying, a single risk factor must be considered, which must be mapped to that maturity;

(b) where the maturity of the option is shorter than the maturity of the underlying, the following risk factors must be considered as follows–

(i) the first risk factor must be mapped to the maturity of the option;

(ii) the second risk factor must be mapped to the residual maturity of the underlying of the option at the expiry date of the option.

(8) The curvature general interest rate risk factors to be applied by institutions must consist of one vector of risk-free rates, representing a specific risk-free yield curve, per currency. Each currency must constitute a different bucket. For each instrument, the vector must contain as

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

many components as there are different maturities of risk-free rates used as variables by the institution's pricing model for that instrument.

(9) Institutions must calculate the sensitivity of the instrument to each risk factor used in the curvature risk formula in accordance with Article 325G. For the purposes of the curvature risk, institutions must consider vectors corresponding to different yield curves and with a different number of components as the same risk factor, if those vectors correspond to the same currency. Institutions must offset sensitivities to the same risk factor. There must be only one net sensitivity per bucket.

There must be no curvature risk own funds requirements for inflation and cross currency basis risks.

Credit spread risk factors for non-securitisation.

325M.(1) The delta credit spread risk factors to be applied by institutions to non-securitisation instruments that are sensitive to credit spread must be the issuer credit spread rates of those instruments, inferred from the relevant debt instruments and credit default swaps, and mapped to each of the following maturities– 0.5 years, 1 year, 3 years, 5 years, 10 years. Institutions must apply one risk factor per issuer and maturity, regardless of whether those issuer credit spread rates are inferred from debt instruments or credit default swaps. The buckets must be sector buckets, as referred to in Articles 325AE to 325AY, and each bucket must include all the risk factors allocated to the relevant sector.

(2) The vega credit spread risk factors to be applied by institutions to options with non-securitisation underlyings that are sensitive to credit spread must be the implied volatilities of the underlying's issuer credit spread rates inferred as laid down in paragraph (1), which must be mapped to the following maturities in accordance with the maturity of the option subject to own funds requirements– 0.5 years, 1 year, 3 years, 5 years, 10 years. The same buckets must be used as the buckets that were used for the delta credit spread risk for non-securitisation.

(3) The curvature credit spread risk factors to be applied by institutions to non-securitisation instruments must consist of one vector of credit spread rates, representing a credit spread curve specific to the issuer. For each instrument, the vector must contain as many components as there are different maturities of credit spread rates used as variables in the institution's pricing model for that instrument. The same buckets must be used as the buckets that were used for the delta credit spread risk for non-securitisation.

(4) Institutions must calculate the sensitivity of the instrument to each risk factor used in the curvature risk formula in accordance with Article 325G. For the purposes of the curvature risk, institutions must consider vectors inferred from either relevant debt instruments or credit

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

default swaps and with a different number of components as the same risk factor, if those vectors correspond to the same issuer.

Credit spread risk factors for securitisation.

325N.(1) Institutions must apply the credit spread risk factors referred to in paragraph (3) to securitisation positions that are included in the ACTP, as referred to in Article 325(6), (7) and (8),

Institutions must apply the credit spread risk factors referred to in paragraph (5) to securitisation positions that are not included in the ACTP, as referred to in Article 325(6), (7) and (8).

(2) The buckets applicable to the credit spread risk for securitisations that are included in the ACTP must be the same as the buckets applicable to the credit spread risk for non-securitisations, as referred to in Articles 325AE to 325AY.

The buckets applicable to the credit spread risk for securitisations that are not included in the ACTP must be specific to that risk-class category, as referred to in Articles 325AE to 325AY.

(3) The credit spread risk factors to be applied by institutions to securitisation positions that are included in the ACTP are the following–

(a) the delta risk factors must be all the relevant credit spread rates of the issuers of the underlying exposures of the securitisation position, inferred from the relevant debt instruments and credit default swaps, and for each of the following maturities– 0.5 years, 1 year, 3 years, 5 years, 10 years.

(b) the vega risk factors applicable to options with securitisation positions that are included in the ACTP as underlyings must be the implied volatilities of the credit spreads of the issuers of the underlying exposures of the securitisation position, inferred as described in sub-paragraph (a), which must be mapped to the following maturities in accordance with the maturity of the corresponding option subject to own funds requirements– 0.5 years, 1 year, 3 years, 5 years, 10 years.

(c) the curvature risk factors must be the relevant credit spread yield curves of the issuers of the underlying exposures of the securitisation position expressed as a vector of credit spread rates for different maturities, inferred as indicated in sub-paragraph (a); for each instrument, the vector must contain as many components as there are different maturities of credit spread rates that are used as variables by the institution's pricing model for that instrument.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(4) Institutions must calculate the sensitivity of the securitisation position to each risk factor used in the curvature risk formula as specified in Article 325G. For the purposes of the curvature risk, institutions must consider vectors inferred either from relevant debt instruments or credit default swaps and with a different number of components as the same risk factor, if those vectors correspond to the same issuer.

(5) The credit spread risk factors to be applied by institutions to securitisation positions that are not included in the ACTP must refer to the spread of the tranche rather than the spread of the underlying instruments and must be the following–

(a) the delta risk factors must be the relevant tranche credit spread rates, mapped to the following maturities, in accordance with the maturity of the tranche– 0.5 years, 1 year, 3 years, 5 years, 10 years;

(b) the vega risk factors applicable to options with securitisation positions that are not included in the ACTP as underlyings must be the implied volatilities of the credit spreads of the tranches, each of them mapped to the following maturities in accordance with the maturity of the option subject to own funds requirements– 0.5 years, 1 year, 3 years, 5 years, 10 years;

(c) the curvature risk factors must be the same as those described in sub-paragraph (a); to all those risk factors, a common risk weight must be applied, as referred to in Articles 325AE to 325AY.

Equity risk factors.

325O.(1) The buckets for all equity risk factors must be the sector buckets referred to in Articles 325AE to 325AY.

(2) The equity delta risk factors to be applied by institutions must be all the equity spot prices and all equity repo rates.

For the purposes of equity risk, a specific equity repo curve must constitute a single risk factor, which is expressed as a vector of repo rates for different maturities. For each instrument, the vector must contain as many components as there are different maturities of repo rates that are used as variables by the institution's pricing model for that instrument.

Institutions must calculate the sensitivity of an instrument to an equity risk factor as the change in the value of the instrument, according to its pricing model, as a result of a 1 basis point shift in each of the components of the vector. Institutions must offset sensitivities to the repo rate risk factor of the same equity security, regardless of the number of components of each vector.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(3) The equity vega risk factors to be applied by institutions to options with underlyings that are sensitive to equity must be the implied volatilities of equity spot prices which are mapped to the following maturities in accordance with the maturities of the corresponding options subject to own funds requirements – 0.5 years, 1 year, 3 years, 5 years, 10 years. There must be no own funds requirements for vega risk for equity repo rates.

(4) The equity curvature risk factors to be applied by institutions to options with underlyings that are sensitive to equity are all the equity spot prices, regardless of the maturity of the corresponding options. There are no curvature risk own funds requirements for equity repo rates.

Commodity risk factors.

325P.(1) The buckets for all commodity risk factors are the sector buckets referred to in Articles 325AE to 325AY.

(2) The commodity delta risk factors to be applied by institutions to commodity sensitive instruments must be all the commodity spot prices per commodity type and per each of the following maturities– 0.25 years, 0.5 years, 1 year, 2 years, 3 years, 5 years, 10 years, 15 years, 20 years, 30 years. Institutions must only consider two commodity prices of the same type of commodity, and with the same maturity to constitute the same risk factor where the set of legal terms regarding the delivery location are identical.

(3) The commodity vega risk factors to be applied by institutions to options with underlyings that are sensitive to commodity must be the implied volatilities of commodity prices per commodity type, which must be mapped to the following maturities in accordance with the maturities of the corresponding options subject to own funds requirements– 0.5 years, 1 year, 3 years, 5 years, 10 years. Institutions must consider sensitivities to the same commodity type and allocated to the same maturity to be a single risk factor which institutions must then offset.

(4) The commodity curvature risk factors to be applied by institutions to options with underlyings that are sensitive to commodity must be one set of commodity prices with different maturities per commodity type, expressed as a vector. For each instrument, the vector must contain as many components as there are prices of that commodity that are used as variables by the institution's pricing model for that instrument. Institutions must not differentiate between commodity prices by delivery location.

The sensitivity of the instrument to each risk factor used in the curvature risk formula must be calculated as specified in Article 325G. For the purposes of curvature risk, institutions must consider vectors having a different number of components to constitute the same risk factor, if those vectors correspond to the same commodity type.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Foreign exchange risk factors.

325Q.(1) The foreign exchange delta risk factors to be applied by institutions to foreign exchange sensitive instruments must be all the spot exchange rates between the currency in which an instrument is denominated and the institution's reporting currency. There must be one bucket per currency pair, containing a single risk factor and a single net sensitivity.

(2) The foreign exchange vega risk factors to be applied by institutions to options with underlyings that are sensitive to foreign exchange must be the implied volatilities of exchange rates between the currency pairs referred to in paragraph (1). Those implied volatilities of exchange rates must be mapped to the following maturities in accordance with the maturities of the corresponding options subject to own funds requirements– 0.5 years, 1 year, 3 years, 5 years, 10 years.

(3) The foreign exchange curvature risk factors to be applied by institutions to options with underlyings that are sensitive to foreign exchange must be the same as those referred to in paragraph (1).

(4) Institutions must not be required to distinguish between onshore and offshore variants of a currency for all foreign exchange delta, vega and curvature risk factors.

Delta risk sensitivities.

325R.(1) Institutions must calculate delta general interest rate risk (GIRR) sensitivities as follows–

(a) the sensitivities to risk factors consisting of risk-free rates are calculated as follows–

$$S_{r_{kt}} = \frac{V_i(r_{kt}+0{,}0001,\ x,\ y\ \ldots) - V_i(r_{kt},\ x,\ y\ \ldots)}{0{,}0001}$$

where–

= the sensitivities to risk factors consisting of risk-free rates;

r kt = the rate of a risk-free curve k with maturity t;

V i (.) = the pricing function of instrument i; and

x,y = risk factors other than r kt in the pricing function V i ;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(b) the sensitivities to risk factors consisting of inflation risk and cross-currency basis are calculated as follows–

$$S_{x_j} = \frac{V_i\left(\bar{x}_{ji} + 0{,}0001\bar{I}_m, y, z \ldots\right) - V_i\left(\bar{x}_{ji}, y, z \ldots\right)}{0{,}0001}$$

where–

= the sensitivities to risk factors consisting of inflation risk and cross-currency basis;

= a vector of m components representing the implied inflation curve or the cross-currency basis curve for a given currency j with m being equal to the number of inflation or cross-currency related variables used in the pricing model of instrument i;

= the unity matrix of dimension (1 × m);

V i (.) = the pricing function of the instrument i; and

y, z = other variables in the pricing model.

(2) Institutions must calculate the delta credit spread risk sensitivities for all securitisation and non-securitisation positions as follows–

$$S_{CS_{kt}} = \frac{V_i(CS_{kt} + 0{,}0001, x, y \ldots) - V_i(CS_{kt}, x, y \ldots)}{0{,}0001}$$

where–

= the delta credit spread risk sensitivities for all securitisation and non-securitisation positions;

cs kt = the value of the credit spread rate of an issuer j at maturity t;

V i (.) = the pricing function of instrument i; and

x,y = risk factors other than cs kt in the pricing function V i .

(3) Institutions must calculate delta equity risk sensitivities as follows–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) the sensitivities to risk factors consisting of equity spot prices are calculated as follows–

$$S_k = \frac{V_i(1{,}01\ EQ_k, x, y, \ldots) - V_i(EQ_k, x, y, \ldots)}{0{,}01}$$

where–

s k = the sensitivities to risk factors consisting of equity spot prices;

k = a specific equity security;

EQ k = the value of the spot price of that equity security;

V i (.) = the pricing function of instrument i; and

x,y = risk factors other than EQ k in the pricing function V i ;

(b) the sensitivities to risk factors consisting of equity repo rates are calculated as follows–

$$S_{x_k} = \frac{V_i\left(\bar{x}_{ki} + 0{,}0001\bar{I}_m, y, z \ldots\right) - V_i(\bar{x}_{ki}, y, z \ldots)}{0{,}0001}$$

where–

= the sensitivities to risk factors consisting of equity repo rates;

k = the index that denotes the equity;

= a vector of m components representing the repo term structure for a specific equity k with m being equal to the number of repo rates corresponding to different maturities used in the pricing model of instrument i;

= the unity matrix of dimension (1 · m);

V i (.) = the pricing function of the instrument i; and

y,z = risk factors other than in the pricing function V i .

(4) Institutions must calculate the delta commodity risk sensitivities to each risk factor k as follows–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

$$S_k = \frac{V_i(1{,}01\ CTY_k, y, z \ldots) - V_i(CTY_k, y, z \ldots)}{0{,}01}$$

where–

s k = the delta commodity risk sensitivities;

k = a given commodity risk factor;

CTY k = the value of risk factor k;

V i (.) = the market value of instrument i as a function of risk factor k; and

y, z = risk factors other than CTY k in the pricing model of instrument i.

(5) Institutions must calculate the delta foreign exchange risk sensitivities to each foreign exchange risk factor k as follows–

$$S_k = \frac{V_i(1{,}01\ FX_k, y, z \ldots) - V_i(FX_k, y, z \ldots)}{0{,}01}$$

where–

s k = the delta foreign exchange risk sensitivities;

k = a given foreign exchange risk factor;

FX k = the value of the risk factor;

V i (.) = the market value of instrument i as a function of the risk factor k; and

y, z = risk factors other than FX k in the pricing model of instrument i.

Vega risk sensitivities.

325S.(1) Institutions must calculate the vega risk sensitivity of an option to a given risk factor k as follows–

$$S_k = \frac{V_i(1{,}01 + vol_k, x, y) - V_i(vol_k, x, y)}{0{,}01}$$

where–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

s_k = the vega risk sensitivity of an option;

k = a specific vega risk factor, consisting of an implied volatility;

vol_k = the value of that risk factor, which should be expressed as a percentage; and

x,y = risk factors other than vol_k in the pricing function V_i .

(2) In the case of risk classes where vega risk factors have a maturity dimension, but where the rules to map the risk factors are not applicable because the options do not have a maturity, institutions must map those risk factors to the longest prescribed maturity. Those options are subject to the residual risks add-on.

(3) In the case of options that do not have a strike or barrier and options that have multiple strikes or barriers, institutions must apply the mapping to strikes and maturity used internally by the institution to price the option. Those options must also be subject to the residual risks add-on.

(4) Institutions must not calculate the vega risk for securitisation tranches included in the ACTP, as referred to in Article 325(6), (7) and (8), that do not have an implied volatility. Own funds requirements for delta and curvature risk must be computed for those securitisation tranches.

Requirements on sensitivity computations.

325T.(1) Institutions must derive sensitivities from the institution's pricing models that serve as a basis for reporting profit and loss to senior management, using the formulas set out in this Article and Articles 325R and 325S (the “relevant formulas”).

By way of derogation from the first sub-paragraph, the GFSC may require an institution that has been granted approval to use the alternative internal model approach set out in Chapter 1b to use the pricing functions of the risk-measurement system of their internal model approach in the calculation of sensitivities under this Chapter for the calculation and reporting of the own funds requirements for market risk in accordance with Article 430B(3) (to the extent it applies on or after 1st February 2026).

(2) When calculating delta risk sensitivities of instruments with optionality as referred to in Article 325E(2)(a), institutions may assume that the implied volatility risk factors remain constant.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(3) When calculating vega risk sensitivities of instruments with optionality as referred to in Article 325E(2)(b), the following requirements must apply–

(a) for general interest rate risk and credit spread risk, institutions must assume, for each currency, that the underlying of the volatility risk factors for which vega risk is calculated follows either a lognormal or normal distribution in the pricing models used for those instruments;

(b) for equity risk, commodity risk and foreign exchange risk, institutions must assume that the underlying of the volatility risk factors for which vega risk is calculated follows a lognormal distribution in the pricing models used for those instruments.

(4) Institutions must calculate all sensitivities except for the sensitivities to credit valuation adjustments.

(5) By way of derogation from paragraph (1), subject to GFSC approval, an institution may use alternative definitions of delta risk sensitivities in the calculation of the own funds requirements of a trading book position under this Chapter, if the institution meets all the following conditions–

(a) those alternative definitions are used for internal risk management purposes and for the reporting of profits and losses to senior management by an independent risk control unit within the institution;

(b) the institution demonstrates that those alternative definitions are more appropriate for capturing the sensitivities for the position than the relevant formulas, and that the resulting sensitivities do not materially differ from those formulas.

(6) By way of derogation from paragraph (1), subject to GFSC approval, an institution may calculate vega sensitivities on the basis of a linear transformation of alternative definitions of sensitivities in the calculation of the own funds requirements of a trading book position under this Chapter, if the institution meets both the following conditions–

(a) those alternative definitions are used for internal risk management purposes and for the reporting of profits and losses to senior management by an independent risk control unit within the institution;

(b) the institution demonstrates that those alternative definitions are more appropriate for capturing the sensitivities for the position than the relevant formulas and that the linear transformation referred to in the first sub-paragraph reflects a vega risk sensitivity.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

The residual risk add-on

Own funds requirements for residual risks.

325U.(1) In addition to the own funds requirements for market risk set out in Articles 325D to 325K, institutions must apply additional own funds requirements to instruments exposed to residual risks in accordance with this Article.

(2) Instruments are considered to be exposed to residual risks where they meet any of the following conditions–

(a) the instrument references an exotic underlying, which, for the purposes of this Chapter, means a trading book instrument referencing an underlying exposure that is not in the scope of the delta, vega or curvature risk treatments under the sensitivities-based method laid down in Articles 325D to 325K or the own funds requirements for the default risk set out in Articles 325V to 325AD;

(b) the instrument is an instrument bearing other residual risks, which, for the purposes of this Chapter, means any of the following instruments–

(i) instruments that are subject to the own funds requirements for vega and curvature risk under the sensitivities-based method set out in Articles 325D to 325K and that generate pay-offs that cannot be replicated as a finite linear combination of plain-vanilla options with a single underlying equity price, commodity price, exchange rate, bond price, credit default swap price or interest rate swap;

(ii) instruments that are positions that are included in the ACTP referred to in Article 325(6); hedges that are included in that ACTP, as referred to in Article 325(8), must not be considered.

(3) Institutions must calculate the additional own funds requirements referred to in paragraph (1) as the sum of gross notional amounts of the instruments referred to in paragraph (2), multiplied by the following risk weights–

(a) 1.0% in the case of instruments referred to in paragraph (2)(a);

(b) 0.1% in the case of instruments referred to in paragraph (2)(b).

(4) By way of derogation from paragraph (1), institution must not apply the own funds requirement for residual risks to an instrument that meets any of the following conditions–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) the instrument is listed on a recognised exchange;

(b) the instrument is eligible for central clearing in accordance with EMIR;

(c) the instrument perfectly offsets the market risk of another position in the trading book, in which case the two perfectly matching trading book positions must be exempted from the own funds requirement for residual risks.

(5) [Not used]

Own funds requirements for the default risk

Definitions and general provisions.

325V.(1) For the purposes of Articles 325V to 325AD, the following definitions apply–

(a) "short exposure" means that the default of an issuer or group of issuers leads to a gain for the institution, regardless of the type of instrument or transaction creating the exposure;

(b) "long exposure" means that the default of an issuer or group of issuers leads to a loss for the institution, regardless of the type of instrument or transaction creating the exposure;

(c) "gross jump-to-default (gross JTD) amount" means the estimated size of the loss or gain that the default of the obligor would produce for a specific exposure;

(d) "net jump-to-default (net JTD) amount" means the estimated size of the loss or gain that an institution would incur due to the default of an obligor, after offsetting between gross JTD amounts has taken place,

(e) "loss given default" or "LGD" means the loss given default of the obligor on an instrument issued by that obligor expressed as a share of the notional amount of the instrument;

(f) "default risk weight" means the percentage representing the estimated probability of the default of each obligor, according to the creditworthiness of that obligor.

(2) Own funds requirements for the default risk must apply to debt and equity instruments, to derivative instruments having those instruments as underlyings and to derivatives, the pay-offs or fair values of which are affected by the default of an obligor other than the counterparty

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

to the derivative instrument itself. Institutions must calculate default risk requirements separately for each of the following types of instruments– non-securitisations, securitisations that are not included in the ACTP, and securitisations that are included in the ACTP. The final own funds requirements for the default risk to be applied by institutions must be the sum of those three components.

Gross jump-to-default amounts.

325W.(1) Institutions must calculate the gross JTD amounts for each long exposure to debt instruments as follows–

$$JTD_{long} = \max\{LGD \cdot V_{notional} + P\&L_{long} + Adjustment_{long} ; 0\}$$

where–

JTD_{long} = the gross JTD amount for the long exposure;

$V_{notional}$ = the notional amount of the instrument;

$P\&L_{long}$ = a term which adjusts for gains or losses already accounted for by the institution due to changes in the fair value of the instrument creating the long exposure; gains must enter the formula with a positive sign and losses with a negative; and

$Adjustment_{long}$ = the amount by which, due to the structure of the derivative instrument, the institution's loss in the event of default would be increased or reduced relative to the full loss on the underlying instrument; increases must enter the $Adjustment_{long}$ term with a positive sign and decreases with a negative sign.

(2) Institutions must calculate the gross JTD amounts for each short exposure to debt instruments as follows–

$$JTD_{short} = \min\{LGD \cdot V_{notional} + P\&L_{short} + Adjustment_{short} ; 0\}$$

where–

JTD_{short} = the gross JTD amount for the short exposure;

$V_{notional}$ = the notional amount of the instrument that must enter into the formula with a negative sign;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

P&L short = a term which adjusts for gains or losses already accounted for by the institution due to changes in the fair value of the instrument creating the short exposure; gains must enter into the formula with a positive sign and losses must enter into the formula with a negative sign; and

Adjustment short = the amount by which, due to the structure of the derivative instrument, the institution's gain in the event of default would be increased or reduced relative to the full loss on the underlying instrument; decreases must enter the Adjustment short term with a positive sign and increases must enter the Adjustment short term with a negative sign.

(3) For the purposes of the calculation set out in paragraphs (1) and (2), the LGD for debt instruments to be applied by institutions must be the following–

(a) exposures to non-senior debt instruments are assigned an LGD of 100%;

(b) exposures to senior debt instruments are assigned an LGD of 75%;

(c) exposures to covered bonds, as referred to in Article 129, are assigned an LGD of 25%.

(4) For the purposes of the calculations set out in paragraphs (1) and (2), notional amounts are determined as follows–

(a) in the case of debt instruments, the notional amount is the face value of the debt instrument;

(b) in the case of derivative instruments with debt security underlyings, the notional amount is the notional amount of the derivative instrument.

(5) For exposures to equity instruments, institutions must calculate the gross JTD amounts as follows, instead of using the formulas referred to in paragraphs (1) and (2)–

$$\text{JTD long} = \max\{\text{LGD} \cdot V + \text{P\&L long} + \text{Adjustment long} ; 0\}$$

$$\text{JTD short} = \min\{\text{LGD} \cdot V + \text{P\&L short} + \text{Adjustment short} ; 0\}$$

where–

JTD long = the gross JTD amount for the long exposure;

JTD short = the gross JTD amount for the short exposure; and

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

V = the fair value of the equity or, in the case of derivative instruments with equity underlyings, the fair value of the equity underlying.

(6) Institutions must assign an LGD of 100% to equity instruments for the purposes of the calculation set out in paragraph (5).

(7) In the case of exposures to default risk arising from derivative instruments whose pay-offs in the event of default of the obligor are not related to the notional amount of a specific instrument issued by that obligor or to the LGD of the obligor or an instrument issued by that obligor, institutions must use alternative methodologies to estimate the gross JTD amounts.

(8) [Not used]

Net jump-to-default amounts.

325X.(1) Institutions must calculate net JTD amounts by offsetting the gross JTD amounts of short exposures and long exposures. Offsetting must only be possible between exposures to the same obligor where the short exposures have the same seniority as, or lower seniority than, the long exposures.

(2) Offsetting must be either full or partial, depending on the maturities of the offsetting exposures–

(a) offsetting must be full where all offsetting exposures have maturities of one year or more;

(b) offsetting must be partial where at least one of the offsetting exposures has a maturity of less than one year, in which case the size of the JTD amount of each exposure with a maturity of less than one year must be multiplied by the ratio of the exposure's maturity relative to one year.

(3) Where no offsetting is possible gross JTD amounts must equal net JTD amounts in the case of exposures with maturities of one year or more. Gross JTD amounts with maturities of less than one year must be multiplied by the ratio of the exposure's maturity relative to one year, with a floor of three months, to calculate net JTD amounts.

(4) For the purposes of paragraphs (2) and (3), the maturities of the derivative contracts must be considered, rather than those of their underlyings. Cash equity exposures must be assigned a maturity of either one year or three months, at the institution's discretion.

Calculation of the own funds requirements for the default risk.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

325Y.(1) Net JTD amounts, irrespective of the type of counterparty, must be multiplied by the default risk weights that correspond to their credit quality, as specified in Table 2–

Table 2

Credit quality category	Default risk weight
Credit quality step 1	0,5 %
Credit quality step 2	3 %
Credit quality step 3	6 %
Credit quality step 4	15 %
Credit quality step 5	30 %
Credit quality step 6	50 %
Unrated	15 %
Defaulted	100 %

(2) Exposures which would receive a 0% risk-weight under the Standardised Approach for credit risk in accordance with Chapter 2 of Title 2 must receive a 0% default risk weight for the own funds requirements for the default risk.

(3) The weighted net JTD must be allocated to the following buckets– corporates, sovereigns, and local governments/municipalities.

(4) Weighted net JTD amounts must be aggregated within each bucket, in accordance with the following formula–

$$DRC_b = \max\{(\sum_{i \in long} RW_i \cdot net\ JTD_i) - WtS \cdot (\sum_{i \in short} RW_i \cdot |net\ JTD_i|); 0\}$$

where–

DRC_b = the own funds requirement for the default risk for bucket b;

i = the index that denotes an instrument belonging to bucket b;

RW_i = the risk weight; and

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

WtS = a ratio recognising a benefit for hedging relationships within a bucket is calculated as follows–

$$WtS = \frac{\sum netJTD_{long}}{\sum netJTD_{long} + \sum |netJTD_{short}|}$$

For the purposes of calculating the DRC b and the WtS, the long positions and short positions must be aggregated for all positions within a bucket, regardless of the credit quality step to which those positions are allocated, to produce the bucket-specific own funds requirements for the default risk.

(5) The final own funds requirement for the default risk for non-securitisations are calculated as the simple sum of the bucket-level own funds requirements.

Jump-to-default amounts.

325Z.(1) Gross jump-to-default amounts for securitisation exposures are their market value or, if their market value is not available, their fair value determined in accordance with the applicable accounting framework.

(2) Net jump-to-default amounts are determined by offsetting long gross jump-to-default amounts and short gross jump-to-default amounts. Offsetting must only be possible between securitisation exposures with the same underlying asset pool and belonging to the same tranche. No offsetting is permitted between securitisation exposures with different underlying asset pools, even where the attachment and detachment points are the same.

(3) Where, by decomposing or combining existing securitisation exposures, other existing securitisation exposures can be perfectly replicated, except for the maturity dimension, the exposures resulting from that decomposition or combination may be used instead of the existing securitisation exposures for the purposes of offsetting.

(4) Where, by decomposing or combining existing exposures in underlying names, the entire tranche structure of an existing securitisation exposure can be perfectly replicated, the exposures resulting from that decomposition or combination may be used instead of the existing securitisation exposures for the purposes of offsetting. Where underlying names are used in that manner, they must be removed from the non-securitisation default risk treatment.

(5) Article 325X must apply to both existing securitisation exposures and to securitisation exposures used in accordance with paragraph (3) or (4). The relevant maturities must be those of the securitisation tranches.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Calculation of the own funds requirement for the default risk for securitisations.

325AA.(1) Net JTD amounts of securitisation exposures must be multiplied by 8% of the risk weight that applies to the relevant securitisation exposure, including STS securitisations, in the non-trading book in accordance with the hierarchy of approaches set out in Articles 247 to 270A and irrespective of the type of counterparty.

(2) A maturity of one year is applied to all tranches, where risk weights are calculated in accordance with the SEC-IRBA and SEC-ERBA.

(3) The risk-weighted JTD amounts for individual cash securitisation exposures are capped at the fair value of the position.

(4) Risk-weighted net JTD amounts must be assigned to the following buckets–

(a) one common bucket for all corporates, regardless of the region;

(b) 44 different buckets corresponding to one bucket per region for each of the 11 asset classes defined in the second sub-paragraph.

For the purposes of the first sub-paragraph, the 11 asset classes are ABCP, auto loans/leases, residential mortgage-backed securities (RMBS), credit cards, commercial mortgage-backed securities (CMBS), collateralised loan obligations, collateralised debt obligations squared (CDO-squared), small and medium-sized enterprises (SMEs), student loans, other retail, other wholesale. The four regions are Asia, Europe, North America, and rest of the world.

(5) In order to assign a securitisation exposure to a bucket, institutions must rely on a classification commonly used in the market. Institutions must assign each securitisation exposure to only one of the buckets referred to in paragraph (4). Any securitisation exposure that an institution cannot assign to a bucket for an asset class or region are assigned to the asset class “other retail” or “other wholesale” or to the region “rest of the world”, respectively.

(6) Weighted net JTD amounts are aggregated within each bucket in the same manner as for default risk of non-securitisation exposures, using the formula in Article 325Y(4), resulting in the own funds requirement for the default risk for each bucket.

(7) The final own funds requirement for the default risk for securitisations not included in the ACTP is calculated as the simple sum of the bucket-level own funds requirements.

Scope.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

325AB.(1) For the ACTP, the own funds requirements must include the default risk for securitisation exposures and for non-securitisation hedges. Those hedges are removed from the default risk calculations for non-securitisation. There is no diversification benefit between the own funds requirements for the default risk for non-securitisations, the own funds requirements for the default risk for securitisations not included in the ACTP and own funds requirements for the default risk for securitisations included in the ACTP.

(2) For traded non-securitisation credit and equity derivatives, JTD amounts by individual constituents are determined by applying a look-through approach.

Jump-to-default amounts for the ACTP.

325AC(1) For the purposes of this Article, the following definitions apply–

(a) “decomposition with a valuation model” means that a single name constituent of a securitisation is valued as the difference between the unconditional value of the securitisation and the conditional value of the securitisation assuming that single name defaults with an LGD of 100%;

(b) “replication” means that the combination of individual securitisation index tranches are combined to replicate another tranche of the same index series, or to replicate an untranched position in the index series;

(c) “decomposition” means replicating an index by a securitisation of which the underlying exposures in the pool are identical to the single name exposures that compose the index.

(2) The gross JTD amounts for securitisation exposures and non-securitisation exposures in the ACTP must be their market value or, if their market value is not available, their fair value determined in accordance with the applicable accounting framework.

(3) Nth-to-default products are treated as tranched products with the following attachment and detachment points–

(a) attachment point = (N – 1) / Total Names;

(b) detachment point = N / Total Names;

where “Total Names” must be the total number of names in the underlying basket or pool.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(4) Net JTD amounts are determined by offsetting long gross JTD amounts and short gross JTD amounts. Offsetting must only be possible between exposures that are otherwise identical except for maturity. Offsetting must only be possible as follows–

(a) for indices, index tranches and bespoke tranches, offsetting must be possible across maturities within the same index family, series and tranche, subject to the provisions on exposures of less than one year laid down in Article 325X; long gross JTD amounts and short gross JTD amounts that perfectly replicate each other may be offset through decomposition into single name equivalent exposures using a valuation model; in such cases, the sum of the gross JTD amounts of the single name equivalent exposures obtained through decomposition must be equal to the gross JTD amount of the undecomposed exposure;

(b) offsetting through decomposition as set out is sub-paragraph (a) must not be allowed for resecuritisations or derivatives on securitisation;

(c) for indices and index tranches, offsetting is possible across maturities within the same index family, series and tranche by replication or by decomposition; where the long exposures and short exposures are otherwise equivalent, apart from one residual component, offsetting is allowed and the net JTD amount must reflect the residual exposure;

(d) different tranches of the same index series, different series of the same index and different index families may not be used to offset each other.

Calculation of the own funds requirements for the default risk for the ACTP.

325AD.(1) Net JTD amounts must be multiplied by–

(a) for tranched products, the default risk weights corresponding to their credit quality as specified in Article 325Y(1) and (2);

(b) for non-tranched products, the default risk weights referred to in Article 325AA(1).

(2) Risk-weighted net JTD amounts must be assigned to buckets that correspond to an index.

(3) Weighted net JTD amounts must be aggregated within each bucket in accordance with the following formula–

$$DRC_b = \max \{(\sum_{i \in long} RW_i \cdot net\ JTD_i) - WtS_{ACTP} \cdot (\sum_{i \in short} RW_i \cdot |net\ JTD_i|); 0\}$$

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

where–

DRC b = the own funds requirement for the default risk for bucket b;

i = an instrument belonging to bucket b; and

WtS ACTP = the ratio recognising a benefit for hedging relationships within a bucket, which must be calculated in accordance with the WtS formula set out in Article 325Y(4), but using long positions and short positions across the entire ACTP and not just the positions in the particular bucket.

(4) Institutions must calculate the own funds requirements for the default risk for the ACTP by using the following formula–

$$DRC_{ACTP} = \max\{\sum_b (\max[DRC_b, 0] + 0{,}5 \times (\min[DRC_b, 00]); 0)\}$$

where–

DRC ACTP = the own funds requirement for the default risk for the ACTP; and

DRC b = the own funds requirement for the default risk for bucket b.

Risk weights for general interest rate risk.

325AE.(1) For currencies not included in the most liquid currency sub-category, the risk weights of the sensitivities to the risk-free rate risk factors for each bucket in Table 3 must be specified pursuant to the regulations referred to in Article 461A (to the extent it applies on and after 1st February 2026).

Table 3

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Bucket	Maturity
1	0,25 years
2	0,5 years
3	1 year
4	2 years
5	3 years
6	5 years
7	10 years
8	15 years
9	20 years
10	30 years

(2) A common risk weight both for all the sensitivities to inflation and for cross currency basis risk factors must be specified in the regulations referred to Article 461A (to the extent it applies on and after 1st February 2026).

(3) For the currencies included in the most liquid currency sub-category and the domestic currency of the institution, the risk weights of the risk-free rate risk factors must be the risk weights referred to in Table 3 divided by √2.

Risk weights and correlations

Intra bucket correlations for general interest rate risk.

325AF.(1) Between two weighted sensitivities of general interest rate risk factors WS k and WS l within the same bucket, and with the same assigned maturity but corresponding to different curves, correlation ρ kl must be set at 99.90%.

(2) Between two weighted sensitivities of general interest rate risk factors WS k and WS l within the same bucket, corresponding to the same curve, but having different maturities, correlation must be set in accordance with the following formula–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

$$\max\left[e^{\left(-\theta\times\frac{|T_k-T_l|}{\min\{T_k;\,T_l\}}\right)};\,40\,\%\right]$$

where–

T_k (respectivelyT_l) = the maturity that relates to the risk free rate;

$\theta = 3\%$

(3) Between two weighted sensitivities of general interest rate risk factors WS_k and WS_l within the same bucket, corresponding to different curves and having different maturities, the correlation ρ_{kl} must be equal to the correlation parameter specified in paragraph (2), multiplied by 99.90%.

(4) Between any given weighted sensitivity of general interest rate risk factors WS_k and any given weighted sensitivity of inflation risk factors WS_l, the correlation must be set at 40%.

(5) Between any given weighted sensitivity of cross-currency basis risk factors WS_k and any given weighted sensitivity of general interest rate risk factors WS_l, including another cross-currency basis risk factor, the correlation must be set at 0%.

Correlations across buckets for general interest rate risk.

325AG.(1) The parameter γ_{bc} = 50% must be used to aggregate risk factors belonging to different buckets.

(2) [Not used]

Risk weights for credit spread risk for non-securitisations.

325AH.(1) Risk weights for the sensitivities to credit spread risk factors for non-securitisations must be the same for all maturities (0. years, 1 year, 3 years, 5 years, 10 years) within each bucket in Table 4–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Table 4

Bucket number	Credit quality	Sector	Risk weight (percentage points)
1	All	The government of Gibraltar	0,50 %
2	Credit quality step 1 to 3	Central government, including central banks, of a third country, multilateral development banks and international organisations referred to in Article 117(2) or Article 118	0,5 %
3		Regional or local authority and public sector entities	1,0 %
4		Financial sector entities including credit institutions incorporated or established by a central government, a regional government or a local authority and promotional lenders	5,0 %
5		Basic materials, energy, industrials, agriculture, manufacturing, mining and quarrying	3,0 %
6		Consumer goods and services, transportation and storage, administrative and support service activities	3,0 %
7		Technology, telecommunications	2,0 %
8		Health care, utilities, professional and technical activities	1,5 %
9		Covered bonds issued by credit institutions in Gibraltar	1,0 %
11	Credit quality step 4 to 6	Central government, including central banks, of a third country, multilateral development banks and international organisations referred to in Article 117(2) or Article 118	
12		Regional or local authority and public sector entities	4,0 %
13		Financial sector entities including credit institutions incorporated or established by a central government, a regional government or a local authority and promotional lenders	12,0 %
14		Basic materials, energy, industrials, agriculture, manufacturing, mining and quarrying	7,0 %
15		Consumer goods and services, transportation and storage, administrative and support service activities	8,5 %
16		Technology, telecommunications	5,5 %
17		Health care, utilities, professional and technical activities	5,0 %
18	Other sector		12,0 %

(2) To assign a risk exposure to a sector, institutions must rely on a classification that is commonly used in the market for grouping issuers by sector. Institutions must assign each issuer to only one of the sector buckets in Table 4. Risk exposures from any issuer that an institution cannot assign to a sector in such a manner are assigned to bucket 18 in Table 4.

Intra-bucket correlations for credit spread risk for non-securitisations.

325AI.(1) The correlation parameter ρ_{kl} between two sensitivities WS_k and WS_l within the same bucket are set as follows–

$$\rho_{kl} = \rho_{kl}(\text{name}) \cdot \rho_{kl}(\text{tenor}) \cdot \rho_{kl}(\text{basis})$$

where–

$\rho_{kl}(\text{name})$ must be equal to 1 where the two names of sensitivities k and l are identical, otherwise it must be equal to 35%;

$\rho_{kl}(\text{tenor})$ must be equal to 1 where the two vertices of the sensitivities k and l are identical, otherwise it must be equal to 65%; and

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

ρ_{kl} (basis) must be equal to 1 where the two sensitivities are related to the same curves, otherwise it must be equal to 99.90%.

(2) The correlation parameters referred to in paragraph (1) must not apply to bucket 18 in Table 4 of Article 325AH(1). The capital requirement for the delta risk aggregation formula within bucket 18 must be equal to the sum of the absolute values of the net weighted sensitivities allocated to that bucket–

$$K_{b(bucket\ 18)} = \sum_k |WS_k|$$

Correlations across buckets for credit spread risk for non-securitisations.

325AJ. The correlation parameter γ_{bc} that applies to the aggregation of sensitivities between different buckets are set as follows–

$$\gamma_{bc} = \gamma_{bc}^{(rating)} \cdot \gamma_{bc}^{(sector)}$$

where–

$\gamma_{bc}^{(rating)}$ must be equal to 1 where the two buckets have the same credit quality category (either credit quality step 1 to 3 or credit quality step 4 to 6), otherwise it must be equal to 50%; for the purposes of that calculation, bucket 1 must be considered as belonging to the same credit quality category as buckets that have credit quality step 1 to 3; and

$\gamma_{bc}^{(sector)}$ must be equal to 1 where the two buckets belong to the same sector, and otherwise must be equal to the corresponding percentage set out in Table 5–

Table 5								
Bucket	1, 2 and 11	3 and 12	4 and 13	5 and 14	6 and 15	7 and 16	8 and 17	9
1, 2 and 11		75 %	10 %	20 %	25 %	20 %	15 %	10 %
3 and 12			5 %	15 %	20 %	15 %	10 %	10 %
4 and 13				5 %	15 %	20 %	5 %	20 %
5 and 14					20 %	25 %	5 %	5 %
6 and 15						25 %	5 %	15 %
7 and 16							5 %	20 %
8 and 17								5 %
9								—

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Risk weights for credit spread risk for securitisations included in the ACTP.

325AK. Risk weights for the sensitivities to credit spread risk factors for securitisations included in the ACTP risk factors must be the same for all maturities (0.5 years, 1 year, 3 years, 5 years, 10 years) within each bucket and are specified for each bucket in Table 6 pursuant to the delegated act referred to in Article 461A (to the extent it applies on and after 1st February 2026)–

Table 6

Bucket number	Credit quality	Sector
1	All	The government of Gibraltar
2	Credit quality step 1 to 3	Central government, including central banks, of a third country, multilateral development banks and international organisations referred to in Article 117(2) or Article 118
3		Regional or local authority and public sector entities
4		Financial sector entities including credit institutions incorporated or established by a central government, a regional government or a local authority and promotional lenders
5		Basic materials, energy, industrials, agriculture, manufacturing, mining and quarrying
6		Consumer goods and services, transportation and storage, administrative and support service activities
7		Technology, telecommunications
8		Health care, utilities, professional and technical activities
9		Covered bonds issued by credit institutions in Gibraltar
10		Covered bonds issued by credit institutions in third countries
11	Credit quality step 4 to 6	Central government, including central banks, of a third country, multilateral development banks and international organisations referred to in Article 117(2) or Article 118
12		Regional or local authority and public sector entities
13		Financial sector entities including credit institutions incorporated or established by a central government, a regional government or a local authority and promotional lenders
14		Basic materials, energy, industrials, agriculture, manufacturing, mining and quarrying
15		Consumer goods and services, transportation and storage, administrative and support service activities
16		Technology, telecommunications
17		Health care, utilities, professional and technical activities
18	Other sector	

Correlations for credit spread risk for securitisations included in the ACTP.

325AL.(1) The delta risk correlation ρ_{kl} are derived from Article 325AI, except that, for the purposes of this paragraph, ρ_{kl} (basis) must be equal to 1 where the two sensitivities are related to the same curves, otherwise it must be equal to 99.00%.

(2) The correlation γ_{bc} are derived from Article 325AJ.

Risk weights for credit spread risk for securitisations not included in the ACTP.

325AM.(1) Risk weights for the sensitivities to credit spread risk factors for securitisation not included in the ACTP must be the same for all maturities (0.5 years, 1 year, 3 years, 5 years,

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

10 years) within each bucket in Table 7 and must be specified for each bucket in Table 7 pursuant to the delegated act referred to in Article 461A (to the extent it applies on and after 1st February 2026)–

Table 7

Bucket number	Credit quality	Sector
1	Senior and Credit quality step 1 to 3	RMBS - Prime
2		RMBS - Mid-Prime
3		RMBS - Sub-Prime
4		CMBS
5		Asset backed securities (ABS) - Student loans
6		ABS - Credit cards
7		ABS - Auto
8		Collateralised loan obligations (CLO) non-ACTP
9	Non-senior and credit quality step 1 to 3	RMBS - Prime
10		RMBS - Mid-Prime
11		RMBS - Sub-Prime
12		CMBS
13		ABS - Student loans
14		ABS - Credit cards
15		ABS - Auto
16		CLO non-ACTP
17	Credit quality step 4 to 6	RMBS - Prime
18		RMBS - Mid-Prime
19		RMBS - Sub-Prime
20		CMBS
21		ABS - Student loans
22		ABS - Credit cards
23		ABS - Auto
24		CLO non-ACTP
25	Other sector	

(2) To assign a risk exposure to a sector, institutions must rely on a classification that is commonly used in the market for grouping issuers by sector. Institutions must assign each

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

tranche to one of the sector buckets in Table 7. Risk exposures from any tranche that an institution cannot assign to a sector in such a manner are assigned to bucket 25.

Intra-bucket correlations for credit spread risk for securitisations not included in the ACTP.

325AN.(1) Between two sensitivities WS_k and WS_l within the same bucket, the correlation parameter ρ_{kl} are set as follows–

$$\rho_{kl} = \rho_{kl}^{(tranche)} \cdot \rho_{kl}^{(tenor)} \cdot \rho_{kl}^{(basis)}$$

where–

$\rho_{kl}^{(thranche)}$ must be equal to 1 where the two names of sensitivities k and l are within the same bucket and are related to the same securitisation tranche (more than 80% overlap in notional terms), otherwise it must be equal to 40%;

$\rho_{kl}^{(tenor)}$ must be equal to 1 where the two vertices of the sensitivities k and l are identical, otherwise it must be equal to 80%; and

$\rho_{kl}^{(basis)}$ must be equal to 1 where the two sensitivities are related to the same curves, otherwise it must be equal to 99.90%.

(2) The correlation parameters referred to in paragraph (1) must not apply to bucket 25 in Table 7 of Article 325AM(1). The own funds requirement for the delta risk aggregation formula within bucket 25 must be equal to the sum of the absolute values of the net weighted sensitivities allocated to that bucket–

$$K_{b(bucket\ 25)} = \sum_k |WS_k|$$

Correlations across buckets for credit spread risk for securitisations not included in the ACTP.

325AO(1) The correlation parameter γ_{bc} must apply to the aggregation of sensitivities between different buckets and must be set at 0%.

(2) The own funds requirement for bucket 25 must be added to the overall risk class level capital, with no diversification or hedging effects recognised with any other bucket.

Risk weights for equity risk.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

325AP.(1) Risk weights for the sensitivities to equity and equity repo rate risk factors are specified for each bucket in Table 8 pursuant to the delegated act referred to in Article 461A (to the extent it applies on and after 1st February 2026)–

Table 8

Bucket number	Market capitalisation	Economy	Sector
1	Large	Emerging market economy	Consumer goods and services, transportation and storage, administrative and support service activities, healthcare, utilities
2			Telecommunications, industrials
3			Basic materials, energy, agriculture, manufacturing, mining and quarrying
4			Financials including government-backed financials, real estate activities, technology
5		Advanced economy	Consumer goods and services, transportation and storage, administrative and support service activities, healthcare, utilities
6			Telecommunications, industrials
7			Basic materials, energy, agriculture, manufacturing, mining and quarrying
8			Financials including government-backed financials, real estate activities, technology
9	Small	Emerging market economy	All sectors described under bucket numbers 1, 2, 3 and 4
10		Advanced economy	All sectors described under bucket numbers 5, 6, 7 and 8
11	Other sector		

(2) to (3) [Not used]

(4) When assigning a risk exposure to a sector, institutions must rely on a classification that is commonly used in the market for grouping issuers by sector. Institutions must assign each issuer to one of the sector buckets in Table 8 and must assign all issuers from the same industry to the same sector. Risk exposures from any issuer that an institution cannot assign to a sector in such a manner are assigned to bucket 11 in Table 8. Multinational or multi-sector equity issuers are assigned to a particular bucket on the basis of the most material region and sector in which the equity issuer operates.

Intra-bucket correlations for equity risk.

325AQ.(1) The delta risk correlation parameter ρ_{kl} between two sensitivities WS_k and WS_l within the same bucket must be set at 99.90% where one is a sensitivity to an equity spot price and the other a sensitivity to an equity repo rate, where both are related to the same equity issuer name.

(2) In other cases than the cases referred to in paragraph (1), the correlation parameter ρ_{kl} between two sensitivities WS_k and WS_l to equity spot price within the same bucket are as follows–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) 15% between two sensitivities within the same bucket that fall under the category large market capitalisation, emerging market economy (bucket number 1, 2, 3 or 4);

(b) 25% between two sensitivities within the same bucket that fall under the category large market capitalisation, advanced economy (bucket number 5, 6, 7 or 8);

(c) 7.5% between two sensitivities within the same bucket that fall under the category small market capitalisation, emerging market economy (bucket number 9);

(d) 12.5% between two sensitivities within the same bucket that fall under the category small market capitalisation, advanced economy (bucket number 10).

(3) The correlation parameter ρ kl between two sensitivities W S k and W S l to equity repo rate within the same bucket are set in accordance with paragraph (2).

(4) Between two sensitivities W S k and W S l within the same bucket where one is a sensitivity to an equity spot price and the other a sensitivity to an equity repo rate and both sensitivities relate to a different equity issuer name, the correlation parameter ρkl are set to the correlation parameters specified in paragraph (2), multiplied by 99.90%.

(5) The correlation parameters specified in paragraphs (1) to (4) must not apply to bucket 11. The capital requirement for the delta risk aggregation formula within bucket 11 must be equal to the sum of the absolute values of the net weighted sensitivities allocated to that bucket–

$$K_{b(\text{bucket } 11)} = \sum_k |WS_k|$$

Correlations across buckets for equity risk.

325AR. The correlation parameter γ b c must apply to the aggregation of sensitivities between different buckets. It must be set at 15% where the two buckets fall within buckets 1 to 10.

Risk weights for commodity risk.

325AS. Risk weights for sensitivities to commodity risk factors are specified for each bucket in Table 9 pursuant to the regulations referred to in Article 461A (to the extent it applies on and after 1st February 2026)–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Table 9

Bucket number	Bucket name
1	Energy - solid combustibles
2	Energy - liquid combustibles
3	Energy - electricity and carbon trading
4	Freight
5	Metals – non-precious
6	Gaseous combustibles
7	Precious metals (including gold)
8	Grains and oilseed
9	Livestock and dairy
10	Softs and other agricultural commodities
11	Other commodity

Intra-bucket correlations for commodity risk.

325AT.(1) For the purposes of this Article, any two commodities are considered distinct commodities where there exist in the market two contracts that are differentiated only by the underlying commodity to be delivered against each contract.

(2) The correlation parameter ρ_{kl} between two sensitivities WS_k and WS_l within the same bucket are set as follows–

$$\rho_{kl} = \rho_{kl}^{(commodity)} \cdot \rho_{kl}^{(tenor)} \cdot \rho_{kl}^{(basis)}$$

where–

$\rho_{kl}^{(commodity)}$ must be equal to 1 where the two commodities of sensitivities k and l are identical, otherwise it must be equal to the intra-bucket correlations in Table 10;

$\rho_{kl}^{(tenor)}$ must be equal to 1 where the two vertices of the sensitivities k and l are identical, otherwise it must be equal to 99%; and

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

$\rho_{kl}^{(basis)}$ must be equal to 1 where the two sensitivities are identical in the delivery location of a commodity, otherwise it must be equal to 99.90%.

(3) The intra-bucket correlations $\rho_{kl}^{(commodity)}$ are–

Table 10

Bucket number	Bucket name	Correlation ρ_{kl} (commodity)
1	Energy - solid combustibles	55 %
2	Energy - liquid combustibles	95 %
3	Energy - electricity and carbon trading	40 %
4	Freight	80 %
5	Metals – non-precious	60 %
6	Gaseous combustibles	65 %
7	Precious metals (including gold)	55 %
8	Grains and oilseed	45 %
9	Livestock and dairy	15 %
10	Softs and other agricultural commodities	40 %
11	Other commodity	15 %

(4) Despite paragraph (1), the following provisions apply–

(a) two risk factors that are allocated to bucket 3 in Table 10 and that concern electricity which is generated in different regions or is delivered at different periods under the contractual agreement are considered distinct commodity risk factors;

(b) two risk factors that are allocated to bucket 4 in Table 10 and that concern freight where the freight route or week of delivery differ are considered distinct commodity risk factors.

Correlations across buckets for commodity risk.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

325AU. The correlation parameter γ b c applying to the aggregation of sensitivities between different buckets are set at–

(a) 20% where the two buckets fall within bucket numbers 1 to 10;

(b) 0% where either of the two buckets is bucket number 11.

Risk weights for foreign exchange risk.

325AV.(1) Risk weight for all sensitivities to foreign exchange risk factors are specified in the regulations referred to in Article 461A (to the extent it applies on and after 1st February 2026).

(2) The risk weight of the foreign exchange risk factors concerning currency pairs which are composed of the euro and the currency of a Member State participating in the second stage of the economic and monetary union (ERM II) must be one of the following–

(a) the risk weight referred to in paragraph (1), divided by 3;

(b) the maximum fluctuation within the fluctuation band formally agreed by the Member State and the European Central Bank, if that fluctuation band is narrower than the fluctuation band defined under ERM II.

(3) Despite paragraph (2), the risk weight of the foreign exchange risk factors concerning currencies referred to in paragraph (2) which participate in the ERM II with a formally agreed fluctuation band narrower than the standard band of plus or minus 15% must equal the maximum percentage fluctuation within that narrower band.

(4) The risk weight of the foreign exchange risk factors included in the most liquid currency pairs sub-category must be the risk weight referred to in paragraph (1) divided by √2.

(5) Where the daily exchange-rate data for the preceding three years show that a currency pair composed of euro and a non-euro currency of an EU Member State is constant and that the institution is always able to face a zero bid/ask spread on the respective trades related to that currency pair, the institution may apply the risk weight referred to in paragraph (1) divided by 2, if it has GFSC approval.

Correlations for foreign exchange risk.

325AW. A uniform correlation parameter γ b c equal to 60% must apply to the aggregation of sensitivities to foreign exchange risk factors.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Vega and curvature risk weights.

325AX.(1) Vega risk factors must use the delta buckets referred to in Articles 325AE to 325AW.

(2) The risk weight for a given vega risk factor k is determined as a share of the current value of that risk factor k which represents the implied volatility of an underlying, as described in Articles 325L to 325T.

(3) The share referred to in paragraph (2) must be made dependent on the presumed liquidity of each type of risk factor in accordance with the following formula–

$$RW_k = (\text{Value of risk factor k}) \times \min\left\{RW_\sigma \times \frac{\sqrt{LH_{\text{risk class}}}}{\sqrt{10}}; 100\%\right\}$$

where–

RW k = the risk weight for a given vega risk factor k;

RW σ must be set at 55%; and

LH risk class is the regulatory liquidity horizon to be prescribed in the determination of each vega risk factor k. LH risk class is determined in accordance with the following table–

Table 11	
Risk class	$LH_{\text{risk class}}$
GIRR	60
CSR non-securitisations	120
CSR securitisations (ACTP)	120
CSR securitisations (non-ACTP)	120
Equity (large cap)	20
Equity (small cap)	60
Commodity	120
Foreign exchange	40

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(4) Buckets used in the context of delta risk in Articles 325AE to 325AW must be used in the curvature risk context unless specified otherwise in this Chapter.

(5) For foreign exchange and equity curvature risk factors, the curvature risk weights must be relative shifts equal to the delta risk weights referred to in Articles 325AE to 325AW.

(6) For general interest rate, credit spread and commodity curvature risk factors, the curvature risk weight must be the parallel shift of all the vertices for each curve on the basis of the highest prescribed delta risk weight referred to in Articles 325AE to 325AW for the relevant risk class.

Vega and curvature risk correlations.

325AY.(1) Between vega risk sensitivities within the same bucket of the general interest rate risk (GIRR) class, the correlation parameter r kl is set as follows–

$$\rho_{kl} = \min\left\{\rho^{kl}_{(\text{option maturity})} \times \rho^{kl}_{(\text{underlying maturity})};1\right\}$$

where–

$\rho^{kl}_{(\text{option maturity})}$

must be equal to

$e^{-\alpha \times \frac{|T_k - T_l|}{\min\{T_k;\, T_l\}}}$

where α must be set at 1%, T_k and T_l must be equal to the maturities of the options for which the vega sensitivities are derived, expressed as a number of years; and

$\rho^{kl}_{(\text{underlying maturity})}$

is equal to

$e^{-\alpha \times \frac{|T_U^k - T_U^l|}{\min\{T_U^k;\, T_U^l\}}}$

, where α is set at 1%,

T_U^k

and

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

T_U^l

must be equal to the maturities of the underlyings of the options for which the vega sensitivities are derived, minus the maturities of the corresponding options, expressed in both cases as a number of years.

(2) Between vega risk sensitivities within a bucket of the other risk classes, the correlation parameter ρ_{kl} must be set as follows–

$$\rho_{kl} = \min\left\{\rho_{(DELTA)}^{kl} \times \rho_{(option\ maturity)}^{kl};1\right\}$$

where–

$\rho_{(DELTA)}^{kl}$

must be equal to the delta intra-bucket correlation corresponding to the bucket to which vega risk factors k and l would be allocated; and

$\rho_{(option\ maturity)}^{kl}$

must be set in accordance with paragraph (1).

(3) With regard to vega risk sensitivities between buckets within a risk class (GIRR and non-GIRR), the same correlation parameters for γ_{bc}, as specified for delta correlations for each risk class in Article 325U, must be used in the vega risk context.

(4) There must be no diversification or hedging benefit recognised in the standardised approach between vega risk factors and delta risk factors. Vega risk charges and delta risk charges must be aggregated by simple summation.

(5) The curvature risk correlations must be the square of corresponding delta risk correlations ρ_{kl} and γ_{bc} referred to in Articles 325AE to 325AW

CHAPTER 1B
ALTERNATIVE INTERNAL MODEL APPROACH

Approval and own funds requirements

Alternative internal model approach and approval to use alternative internal models.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

325AZ.(1) The alternative internal model approach as set out in this Chapter must be used only for the purposes of the reporting requirement laid down in Article 430B(3) (to the extent it applies on or after 1st February 2026).

(2) After having verified institutions' compliance with the requirements set out in Articles 325BH, 325BI and 325NJ, the GFSC may grant approval to those institutions to calculate their own funds requirements for the portfolio of all positions assigned to trading desks by using their alternative internal models in accordance with Article 325BA, if all the following requirements are met–

(a) the trading desks were established in accordance with Article 104B;

(b) the institution has provided to the GFSC a rationale for the inclusion of the trading desks in the scope of the alternative internal model approach;

(c) the trading desks have met the back-testing requirements referred to in Article 325BF(3) for the preceding year;

(d) the institution has reported to the GFSC the results of the profit and loss attribution ("P&L attribution") requirement for the trading desks set out in Article 325BG;

(e) for trading desks that have been assigned at least one of those trading book positions referred to in Article 325BL, the trading desks fulfil the requirements set out in Article 325BM for the internal default risk model;

(f) no securitisation or re-securitisation positions have been assigned to the trading desks.

For the purposes of sub-paragraph (b) of the first sub-paragraph of this paragraph, not including a trading desk in the scope of the alternative internal model approach must not be motivated by the fact that the own funds requirement calculated under the alternative standardised approach set out in Article 325(3)(a) would be lower than the own funds requirement calculated under the alternative internal model approach.

(3) Institutions that have received the approval to use the alternative internal model approach must report to the GFSC in accordance with Article 430B(3) (to the extent it applies on or after 1st February 2026).

(4) An institution that has been granted the approval referred to in paragraph (2) must immediately notify the GFSC that one of its trading desks no longer meets at least one of the requirements set out in that paragraph. That institution must no longer be permitted to apply

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

this Chapter to any of the positions assigned to that trading desk and must calculate the own funds requirements for market risk in accordance with the approach set out in Chapter 1A for all the positions assigned to that trading desk from the earliest reporting date and until the institution demonstrates to the GFSC that the trading desk again fulfils all the requirements set out in paragraph (2).

(5) By way of derogation from paragraph (4), in extraordinary circumstances, the GFSC may permit an institution to continue using its alternative internal models for the purpose of calculating the own funds requirements for the market risk of a trading desk that no longer meets the conditions referred to in paragraph (2)(c) and in Article 325BG(1).

(6) For positions assigned to the trading desks for which an institution has not been granted approval as referred to in paragraph (2), the own funds requirements for market risk is calculated by that institution in accordance with Chapter 1A of this Title. For the purposes of that calculation, all those positions are considered on a stand-alone basis as a separate portfolio.

(7) Material changes to the use of alternative internal models that an institution has received approval to use, the extension of the use of alternative internal models that the institution has received approval to use, and material changes to the institution's choice of the subset of the modellable risk factors referred to in Article 325BC(2), must require separate GFSC approval.

Institutions must notify the GFSC of all other extensions and changes to the use of the alternative internal models for which the institution has received approval.

(8) [Not used]

(9) [Not used]

Own funds requirements when using alternative internal models.

325BA.(1) An institution using an alternative internal model must calculate the own funds requirements for the portfolio of all positions assigned to the trading desks for which the institution has been granted approval as referred to in Article 325AZ(2) as the higher of the following–

(a) the sum of the following values–

(i) the institution's previous day's expected shortfall risk measure, calculated in accordance with Article 325BB (ES_{t-1}); and

(ii) the institution's previous day's stress scenario risk measure, calculated in accordance with Article 325V (SS_{t-1}); or

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(b) the sum of the following values–

(i) the average of the institution's daily expected shortfall risk measure, calculated in accordance with Article 325BB for each of the preceding sixty business days (ES_{avg}), multiplied by the multiplication factor (m_c); and

(ii) the average of the institution's daily stress scenario risk measure, calculated in accordance with Article 325V for each of the preceding sixty business days (SS_{avg}).

(2) Institutions holding positions in traded debt and equity instruments that are included in the scope of the internal default risk model and assigned to the trading desks referred to in paragraph (1) must fulfil an additional own funds requirement, expressed as the higher of the following values–

(a) the most recent own funds requirement for default risk, calculated in accordance with Articles 325L to 325T;

(b) the average of the amount referred to in sub-paragraph (a) over the preceding 12 weeks.

General requirements

Expected shortfall risk measure.

325BB.(1) Institutions must calculate the expected shortfall risk measure referred to in Article 325BA(1)(a) for any given date ‘t’ and for any given portfolio of trading book positions as follows–

$$\mathrm{ES}_t = \rho \times (\mathrm{UES}_t) + (1 - \rho) \times \sum_i \mathrm{UES}_t^i$$

where–

ES_t = the expected shortfall risk measure;

i = the index that denotes the five broad categories of risk factors listed in the first column of Table 2 of Article 325BD;

UES_t = the unconstrained expected shortfall measure calculated as follows–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

$$UES_t = PES^t_{RS} \times \max\left(\frac{PES^t_{FC}}{PES^t_{RC}}, 1\right)$$

UES^t_i = the unconstrained expected shortfall measure for broad risk factor category i and calculated as follows–

$$UES^t_i = PES^t_{RS,i} \times \max\left(\frac{PES^t_{FC,i}}{PES^t_{RC,i}}, 1\right)$$

ρ = the supervisory correlation factor across broad categories of risk; ρ = 50%;

PES^t_{RS} = the partial expected shortfall measure that must be calculated for all the positions in the portfolio in accordance with Article 325BC(2);

PES^t_{RC} = the partial expected shortfall measure that must be calculated for all the positions in the portfolio in accordance with Article 325BC(3);

PES^t_{FC} = the partial expected shortfall measure that must be calculated for all the positions in the portfolio in accordance with Article 325BC(4);

$PES^t_{RS,i}$ = the partial expected shortfall measure for broad risk factor category i that must be calculated for all the positions in the portfolio in accordance with Article 325BC(2);

$PES^t_{RC,i}$ = the partial expected shortfall measure for broad risk factor category i that must be calculated for all the positions in the portfolio in accordance with Article 325BC(3); and

$PES^t_{FC,i}$ = the partial expected shortfall measure for broad risk factor category i that must be calculated for all the positions in the portfolio in accordance with of Article 325BC(4).

(2) Institutions must only apply scenarios of future shocks to the specific set of modellable risk factors applicable to each partial expected shortfall measure, as set out in Article 325BC, when determining each partial expected shortfall measure for the calculation of the expected shortfall risk measure in accordance with paragraph (1).

(3) Where at least one transaction of the portfolio has at least one modellable risk factor which has been mapped to the broad risk factor category i in accordance with Article 325BD, institutions must calculate the unconstrained expected shortfall measure for the broad risk factor category i and include it in the formula for the expected shortfall risk measure referred to in paragraph (1).

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(4) By way of derogation from paragraph (1), an institution may reduce the frequency of the calculation of the unconstrained expected shortfall measures–

UES_i^t

and of the partial expected shortfall measures
$PES_{RS,i}^t$
,
$PES_{RC,i}^t$

and

$PES_{FC,i}^t$

for all broad risk factor categories i from daily to weekly, if both of the following conditions are met–

(a) the institution is able to demonstrate to its competent authority that calculating the unconstrained expected shortfall measure

UES_i^t

does not underestimate the market risk of the relevant trading book positions;

(b) the institution is able to increase the frequency of calculation of
UES_i^t
,
$PES_{RS,i}^t$
,
$PES_{RC,i}^t$

and
$PES_{FC,i}^t$

from weekly to daily where required by the GFSC.

Partial expected shortfall calculations.

325BC.(1) Institutions must calculate all the partial expected shortfall measures referred to in Article 325BB(1) as follows–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) daily calculations of the partial expected shortfall measures;

(b) at 97,5th percentile, one tailed confidence interval;

(c) for a given portfolio of trading book positions, institution must calculate the partial expected shortfall measure at time ‘ t ’ accordance with the following formula–

$$\mathbf{PES}_t = \sqrt{(\mathbf{PES}_t(T))^2 + \sum_{j \geq 2} \left(\mathbf{PES}_t(\mathbf{T}, \mathbf{j}) \times \sqrt{\frac{(\mathbf{LH}_j - \mathbf{LH}_{j-1})}{10}} \right)}$$

where–

PES_t = the partial expected shortfall measure at time t;

j = the index that denotes the five liquidity horizons listed in the first column of Table 1;

LH_j = the length of liquidity horizons j as expressed in days in Table 1;

T = the base time horizon, where T = 10 days;

$PES_t(T)$ = the partial expected shortfall measure that is determined by applying scenarios of future shocks with a 10-day time horizon only to the specific set of modellable risk factors of the positions in the portfolio set out in paragraphs (2), (3) and (4) for each partial expected shortfall measure referred to in Article 325BB(1); and

$PES_t(T, j)$ = the partial expected shortfall measure that is determined by applying scenarios of future shocks with a 10-day time horizon only to the specific set of modellable risk factors of the positions in the portfolio set out in paragraphs (2), (3) and (4) for each partial expected shortfall measure referred to in Article 325BB(1) and of which the effective liquidity horizon, as determined in accordance with Article 325BD(2), is equal or longer than LH_j.

Table 1

Liquidity horizon j	Length of liquidity horizon j (in days)
1	10
2	20

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

3	40
4	60
5	120

(2) For the purpose of calculating the partial expected shortfall measures–

PES^{t}_{RS}

and

$PES^{t}_{RS,i}$

referred to in Article 325BB(1), in addition to the requirements set out in paragraph (1), institutions must meet the following requirements–

(a) in calculating

PES^{t}_{RS}

, institutions must only apply scenarios of future shocks to a subset of the modellable risk factors of the positions in the portfolio which has been chosen by the institution, to the satisfaction of the GFSC, so that the following condition is met with the sum taken over from the preceding 60 business days–

$$\frac{1}{60} \times \sum_{k=0}^{59} \frac{PES^{t-k}_{RC}}{PES^{t-k}_{FC}} \geq 75\%$$

An institution that no longer meets the requirement referred to in the first paragraph must immediately notify the GFSC thereof and must update the subset of the modellable risk factors within two weeks in order to meet that requirement; where, after two weeks, that institution has failed to meet that requirement, the institution must revert to the approach set out in Chapter 1A to calculate the own funds requirements for market risk for some trading desks, until that institution is able to demonstrate to the GFSC that it is meeting the requirement set out in the first sub-paragraph;

(b) in calculating–

$PES^{t}_{RS,i}$

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

, institutions must only apply scenarios of future shocks to the subset of the modellable risk factors of the positions in the portfolio chosen by the institution for the purposes of sub-paragraph (a) and which have been mapped to the broad risk factor category ‘ i ’ in accordance with Article 325BD;

(c) the data inputs used to determine the scenarios of future shocks applied to the modellable risk factors referred to in sub-paragraphs (a) and (b) must be calibrated to historical data from a continuous 12-month period of financial stress that must be identified by the institution in order to maximise the value of
PES^{t}_{RS};

for the purpose of identifying that stress period, institutions must use an observation period starting at least from 1 January 2007 , to the satisfaction of the GFSC; and

(d) the data inputs of

$PES^{t}_{RS,i}$

must be calibrated to the 12-month stress period that has been identified by the institution for the purposes of sub-paragraph (c).

(3) For the purpose of calculating the partial expected shortfall measures
PES^{t}_{RC}

and

$PES^{t}_{RC,i}$

referred to in Article 325BB(1), institutions must, in addition to the requirements set out in paragraph (1), meet the following requirements–

(a) in calculating

PES^{t}_{RC}

, institutions must only apply scenarios of future shocks to the subset of the modellable risk factors of the positions in the portfolio referred to in paragraph (2)(a);

(b) in calculating

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

$PES^{t}_{RC,i}$

, institutions must only apply scenarios of future shocks to the subset of the modellable risk factors of the positions in the portfolio referred to in paragraph (2)(b);

(c) the data inputs used to determine the scenarios of future shocks applied to the modellable risk factors referred to in sub-paragraphs (a) and (b) must be calibrated to historical data referred to in paragraph (4)(c); those data must be updated on at least a monthly basis.

(4) For the purpose of calculating the partial expected shortfall measures–

PES^{t}_{FC}

and

$PES^{t}_{FC,i}$

referred to in Article 325BB(1), institutions must, in addition to the requirements set out in paragraph (1), meet the following requirements–

(a) in calculating–

PES^{t}_{FC}

, institutions must apply scenarios of future shocks to all the modellable risk factors of the positions in the portfolio;

(b) in calculating–

$PES^{t}_{FC,i}$

, institutions must apply scenarios of future shocks to all the modellable risk factors of the positions in the portfolio which have been mapped to the broad risk factor category i in accordance with Article 325BD;

(c) the data inputs used to determine the scenarios of future shocks applied to the modellable risk factors referred to in sub-paragraphs (a) and (b) must be calibrated to historical data from the preceding 12-month period; where there is a significant upsurge in the price volatility of a material number of modellable risks factors of an institution's portfolio which are not in the subset of the risk factors referred to in paragraph (2)(a), the GFSC may require an institution to use historical data for

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

a period shorter than the preceding 12-months, but such a shorter period must not be shorter than the preceding six-months.

(5) In calculating a given partial expected shortfall measure as referred to in Article 325BB(1), institutions must maintain the values of the modellable risks factors for which they have not been required to apply scenarios of future shocks for that partial expected shortfall measure under paragraphs (2), (3) and (4).

Liquidity horizons.

325BD.(1) Institutions must map each risk factor of positions assigned to the trading desks for which they have been granted approval as referred to in Article 325AZ(2), or for which they are in the process of being granted such approval, to one of the broad categories of risk factors listed in Table 2 and to one of the broad sub-categories of risk factors listed in that Table.

(2) The liquidity horizon of a risk factor of the positions referred to in paragraph (1) must be the liquidity horizon of the corresponding broad sub-category of risk factors to which it has been mapped.

(3) By way of derogation from paragraph (1), for a given trading desk, an institution may decide to replace the liquidity horizon of a broad sub-category of risk factors listed in Table 2 with one of the longer liquidity horizons listed in Table 1 of Article 325BC. Where an institution takes such a decision, the longer liquidity horizon must apply to all the modellable risk factors of the positions assigned to that trading desk that have been mapped to that broad sub-category of risk factors for the purpose of calculating the partial expected shortfall measures in accordance with Article 325BC(1)(c).

An institution must notify the GFSC of the trading desks and the broad sub-categories of risk factors to which it decides to apply the treatment referred to in the first sub-paragraph.

(4) For the purpose of calculating the partial expected shortfall measures in accordance with Article 325BC(1)(c), the effective liquidity horizon of a given modellable risk factor of a given trading book position must be calculated as follows–

EffectiveLH =		SubCatLH if $Mat > LH_5$
		$\min(SubCatLH, \min_j \{LH_j / LH_j \geq Mat\})$ if $LH_1 \leq Mat \leq LH_5$
		LH_1 if $Mat < LH_1$

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

where–

EffectiveLH = the effective liquidity horizon;

Mat = the maturity of the trading book position;

SubCatLH = the length of liquidity horizon of the modellable risk factor determined in accordance with paragraph (1); and

$\min_j \{LH_j / LH_j \geq Mat\}$ = the length of one of the liquidity horizons listed in Table 1 of Article 325BC which is the nearest liquidity horizon above the maturity of the trading book position.

(5) [Not used]

(6) An institution must verify the appropriateness of the mapping referred to in paragraph (1) on at least a monthly basis.

(7) [Not used]

Table 2

Broad categories of risk factors	Broad sub-categories of risk factors	Liquidity horizons	Length of the liquidity horizon (in days)
Interest rate	Most liquid currencies and domestic currency	1	10
	Other currencies (excluding most liquid currencies)	2	20
	Volatility	4	60
	Other types	4	60
Credit spread	The Government of Gibraltar	2	20
	Covered bonds issued by credit institutions in Gibraltar (Investment Grade)	2	20
	Sovereign (Investment grade)	2	20
	Sovereign (High yield)	3	40

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

	Corporate (Investment grade)	3	40
	Corporate (High yield)	4	60
	Volatility	5	120
	Other types	5	120
Equity	Equity price (Large market capitalisation)	1	10
	Equity price (Small market capitalisation)	2	20
	Volatility (Large market capitalisation)	2	20
	Volatility (Small market capitalisation)	4	60
	Other types	4	60
Foreign exchange	Most liquid currency pairs	1	10
	Other currency pairs (excluding most liquid currency pairs)	2	20
	Volatility	3	40
	Other types	3	40
Commodity	Energy price and carbon emissions price	2	20
	Precious metal price and non-ferrous metal price	2	20
	Other commodity prices (excluding energy price, carbon emissions price, precious metal price and non-ferrous metal price)	4	60
	Energy volatility and carbon emissions volatility	4	60
	Precious metal volatility and non-ferrous metal volatility	4	60
	Other commodity volatilities (excluding energy volatility, carbon emissions volatility, precious metal volatility and non-ferrous metal volatility)	5	120
	Other types	5	120

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Assessment of the modellability of risk factors.

325BE.(1) Institutions must assess the modellability of all the risk factors of the positions assigned to the trading desks for which they have been granted approval as referred to in Article 325AZ(2) or are in the process of being granted such approval.

(2) As part of the assessment referred to in paragraph (1), institutions must calculate the own funds requirements for market risk in accordance with Article 325BK for those risk factors that are not modellable.

(3) [Not used]

Regulatory back-testing requirements and multiplication factors.

325BF.(1) For the purposes of this Article, an "over-shooting" means a one-day change in the value of a portfolio composed of all the positions assigned to the trading desk that exceeds the related value-at-risk number calculated on the basis of the institution's alternative internal model in accordance with the following requirements–

(a) the calculation of the value at risk is subject to a one-day holding period;

(b) scenarios of future shocks must apply to the risk factors of the trading desk's positions referred to in Article 325BG(3) and which are considered modellable in accordance with Article 325BE;

(c) data inputs used to determine the scenarios of future shocks applied to the modellable risk factors must be calibrated to historical data referred to in Article 325BC(4)(c);

(d) unless stated otherwise in this Article, the institution's alternative internal model is based on the same modelling assumptions as those used for the calculation of the expected shortfall risk measure referred to in Article 325BA(1)(a).

(2) Institutions must count daily over-shootings on the basis of back-testing of the hypothetical and actual changes in the value of the portfolio composed of all the positions assigned to the trading desk.

(3) An institution's trading desk must be deemed to meet the back-testing requirements where the number of over-shootings for that trading desk that occurred over the most recent 250 business days does not exceed any of the following–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) 12 over-shootings for the value-at-risk number, calculated at a 99th percentile one tailed-confidence interval on the basis of back-testing of the hypothetical changes in the value of the portfolio;

(b) 12 over-shootings for the value-at-risk number, calculated at a 99th percentile one tailed-confidence interval on the basis of back-testing of the actual changes in the value of the portfolio;

(c) 30 over-shootings for the value-at-risk number, calculated at a 97,5th percentile one tailed-confidence interval on the basis of back-testing of the hypothetical changes in the value of the portfolio;

(d) 30 over-shootings for the value-at-risk number, calculated at a 97,5th percentile one tailed-confidence interval on the basis of back-testing of the actual changes in the value of the portfolio.

(4) Institutions must count daily over-shootings in accordance with the following–

(a) the back-testing of hypothetical changes in the value of the portfolio is based on a comparison between the end-of-day value of the portfolio and, assuming unchanged positions, the value of the portfolio at the end of the subsequent day;

(b) the back-testing of actual changes in the value of the portfolio is based on a comparison between the end-of-day value of the portfolio and its actual value at the end of the subsequent day, excluding fees and commissions;

(c) an over-shooting must be counted for each business day for which the institution is not able to assess the value of the portfolio or is not able to calculate the value-at-risk number referred to in paragraph (3).

(5) An institution must calculate, in accordance with paragraphs (6) and (7), the multiplication factor (m c) referred to in Article 325BA for the portfolio of all the positions assigned to the trading desks for which it has been granted approval to use alternative internal models as referred to in Article 325AZ(2).

(6) The multiplication factor (m c) must be the sum of the value of 1.5 and an add-on between 0 and 0.5 in accordance with Table 3. For the portfolio referred to in paragraph (5), that add-on must be calculated on the basis of the number of over-shootings that occurred over the most recent 250 business days as evidenced by the institution's back-testing of the value-at-risk number calculated in accordance with sub-paragraph (a). The calculation of the add-on is subject to the following requirements–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) an over-shooting must be a one-day change in the portfolio's value that exceeds the related value-at-risk number calculated by the institution's internal model in accordance with the following–

(i) a one-day holding period;

(ii) a 99th percentile, one tailed confidence interval;

(iii) scenarios of future shocks must apply to the risk factors of the trading desks' positions referred to in Article 325BG(3) and which are considered modellable in accordance with Article 325BE;

(iv) the data inputs used to determine the scenarios of future shocks applied to the modellable risk factors must be calibrated to historical data referred to in Article 325BC(4)(c);

(v) unless stated otherwise in this Article, the institution's internal model must be based on the same modelling assumptions as those used for the calculation of the expected shortfall risk measure referred to in Article 325BA(1)(a);

(b) the number of over shootings must be equal to the greater of the number of over-shootings under hypothetical and the actual changes in the value of the portfolio.

Table 3

Number of overshootings	Add-on
Fewer than 5	0,00
5	0,20
6	0,26
7	0,33
8	0,38
9	0,42
More than 9	0,50

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

In extraordinary circumstances, the GFSC may limit the add-on to that resulting from over-shootings under back-testing hypothetical changes where the number of over-shootings under back-testing actual changes does not result from deficiencies in the internal model.

(7) The GFSC may monitor the appropriateness of the multiplication factor referred to in paragraph (5) and the compliance of trading desks with the back-testing requirements referred to in paragraph (3). Institutions must promptly notify, the GFSC of over-shootings that result from their back-testing programme and provide an explanation for those over-shootings, and in any case must notify the GFSC thereof no later than within five business days after the occurrence of an over-shooting.

(8) By way of derogation from paragraphs (2) and (6), the GFSC may permit an institution not to count an over-shooting where a one-day change in the value of its portfolio that exceeds the related value-at-risk number calculated by that institution's internal model is attributable to a non-modellable risk factor. To do so, the institution must demonstrate to the GFSC that the stress scenario risk measure calculated in accordance with Article 325BK for that non-modellable risk factor is higher than the positive difference between the change in the value of the institution's portfolio and the related value-at-risk number.

(9) [Not used]

Profit and loss attribution requirement.

325BG.(1) An institution's trading desk meets the P&L attribution requirements where that trading desk complies with the requirements set out in this Article.

(2) The P&L attribution requirement must ensure that the theoretical changes in the value of a trading desk's portfolio, based on the institution's risk-measurement model, are sufficiently close to the hypothetical changes in the value of the trading desk's portfolio, based on the institution's pricing model.

(3) For each position of a given trading desk, an institution's compliance with the P&L attribution requirement must lead to the identification of a precise list of risk factors that are deemed appropriate for verifying the institution's compliance with the back-testing requirement set out in Article 325BF.

(4) [Not used]

Requirements on risk measurement.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

325BH.(1) Institutions using an internal risk-measurement model that is used to calculate the own funds requirements for market risk as referred to in Article 325BA must ensure that that model meets all the following requirements–

(a) the internal risk-measurement model must capture a sufficient number of risk factors, which must include at least the risk factors referred to in Articles 325L to 325Q unless the institution demonstrates to the GFSC that the omission of those risk factors does not have a material impact on the results of the P&L attribution requirement referred to in Article 325BG; an institution must be able to explain to the GFSC why it has incorporated a risk factor in its pricing model but not in its internal risk-measurement model;

(b) the internal risk-measurement model must capture nonlinearities for options and other products as well as correlation risk and basis risk;

(c) the internal risk-measurement model must incorporate a set of risk factors that correspond to the interest rates in each currency in which the institution has interest rate sensitive on- or off-balance-sheet positions; the institution must model the yield curves using one of the generally accepted approaches; the yield curve must be divided into various maturity segments to capture the variations of volatility of rates along the yield curve; for material exposures to interest-rate risk in the major currencies and markets, the yield curve must be modelled using a minimum of six maturity segments, and the number of risk factors used to model the yield curve must be proportionate to the nature and complexity of the institution's trading strategies, the model must also capture the risk spread of less than perfectly correlated movements between different yield curves or different financial instruments on the same underlying issuer;

(d) the internal risk-measurement model must incorporate risk factors corresponding to gold and to the individual foreign currencies in which the institution's positions are denominated; for CIUs, the actual foreign exchange positions of the CIU must be taken into account; institutions may rely on third-party reporting of the foreign exchange position of the CIU, if the correctness of that report is adequately ensured; foreign exchange positions of a CIU of which an institution is not aware of must be carved out from the internal models approach and treated in accordance with Chapter 1A;

(e) the sophistication of the modelling technique must be proportionate to the materiality of the institutions' activities in the equity markets; the internal risk-measurement model must use a separate risk factor at least for each of the equity markets in which the institution holds significant positions and at least one risk

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

factor that captures systemic movements in equity prices and the dependency of that risk factor on the individual risk factors for each equity market;

(f) the internal risk-measurement model must use a separate risk factor at least for each commodity in which the institution holds significant positions, unless the institution has a small aggregate commodity position compared to all its trading activities, in which case it may use a separate risk factor for each broad commodity type; for material exposures to commodity markets, the model must capture the risk of less than perfectly correlated movements between commodities that are similar, but not identical, the exposure to changes in forward prices arising from maturity mismatches, and the convenience yield between derivative and cash positions;

(g) the proxies used must show a good track record for the actual position held, must be appropriately conservative, and are used only where the available data are insufficient, such as during the period of stress referred to in Article 325BC(2)(c);

(h) for material exposures to volatility risks in instruments with optionality, the internal risk-measurement model must capture the dependency of implied volatilities across strike prices and options' maturities.

(2) Institutions may use empirical correlations within broad categories of risk factors and, for the purpose of calculating the unconstrained expected shortfall measure UES t as referred to in Article 325BB(1), across broad categories of risk factors only where the institution's approach for measuring those correlations is sound, consistent with the applicable liquidity horizons, and implemented with integrity.

Qualitative requirements.

325BI.(1) Any internal risk-measurement model used for the purposes of this Chapter must be conceptually sound, calculated, implemented with integrity, and comply with all the following qualitative requirements–

(a) any internal risk-measurement model used to calculate capital requirements for market risk must be closely integrated into the daily risk management process of the institution and must serve as the basis for reporting risk exposures to senior management;

(b) an institution must have a risk control unit that is independent from business trading units and that reports directly to senior management; that unit must be responsible for designing and implementing any internal risk-measurement model; that unit must conduct the initial and on-going validation of any internal model

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

used for the purposes of this Chapter and must be responsible for the overall risk management system; that unit must produce and analyse daily reports on the output of any internal model used to calculate capital requirements for market risk, as well as reports on the appropriateness of measures to be taken in terms of trading limits;

(c) the management body and senior management must be actively involved in the risk-control process, and the daily reports produced by the risk control unit must be reviewed at a level of management with sufficient authority to require the reduction of positions taken by individual traders and to require the reduction of the institution's overall risk exposure;

(d) the institution must have a sufficient number of staff with a level of skills that is appropriate to the sophistication of the internal risk-measurement models, and a sufficient number of staff with skills in the trading, risk control, audit and back-office areas;

(e) the institution must have in place a documented set of internal policies, procedures and controls for monitoring and ensuring compliance with the overall operation of its internal risk-measurement models;

(f) any internal risk-measurement model, including any pricing model, must have a proven track record of being reasonably accurate in measuring risks, and must not differ significantly from the models that the institution uses for its internal risk management;

(g) the institution must frequently conduct rigorous programmes of stress testing, including reverse stress tests, which must encompass any internal risk-measurement model; the results of those stress tests must be reviewed by senior management at least on a monthly basis and must comply with the policies and limits approved by the management body; the institution must take appropriate actions where the results of those stress tests show excessive losses arising from the trading's business of the institution under certain circumstances;

(h) the institution must conduct an independent review of its internal risk-measurement models, either as part of its regular internal auditing process, or by mandating a third-party undertaking to conduct that review, which must be conducted to the satisfaction of the GFSC.

For the purposes of sub-paragraph (h), a third-party undertaking means an undertaking that provides auditing or consulting services to institutions and that has staff who have sufficient skills in the area of market risk in trading activities.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(2) The review referred to in paragraph (1)(h) must include both the activities of the business trading units and the independent risk control unit. The institution must conduct a review of its overall risk management process at least once a year. That review must assess the following–

(a) the adequacy of the documentation of the risk management system and process and the organisation of the risk control unit;

(b) the integration of risk measures into daily risk management and the integrity of the management information system;

(c) the processes the institution employs for approving the risk-pricing models and valuation systems that are used by front and back-office personnel;

(d) the scope of risks captured by the model, the accuracy and appropriateness of the risk-measurement system, and the validation of any significant changes to the internal risk-measurement model;

(e) the accuracy and completeness of position data, the accuracy and appropriateness of volatility and correlation assumptions, the accuracy of valuation and risk sensitivity calculations, and the accuracy and appropriateness for generating data proxies where the available data are insufficient to meet the requirement set out in this Chapter;

(f) the verification process that the institution employs to evaluate the consistency, timeliness and reliability of the data sources used to run any of its internal risk-measurement models, including the independence of those data sources;

(g) the verification process that the institution employs to evaluate back-testing requirements and P&L attribution requirements that are conducted in order to assess the accuracy of its internal risk-measurement models;

(h) where the review is performed by a third-party undertaking in accordance with paragraph (1)(h), the verification that the internal validation process set out in Article 325BJ fulfils its objectives.

(3) Institutions must update the techniques and practices they use for any of the internal risk-measurement models used for the purposes of this Chapter to take into account the evolution of new techniques and best practices that develop in respect of those internal risk-measurement models.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Internal validation.

325BJ.(1) Institutions must have processes in place to ensure that any internal risk-measurement models used for the purposes of this Chapter have been adequately validated by suitably qualified parties that are independent of the development process, in order to ensure that any such models are conceptually sound and adequately capture all material risks.

(2) Institutions must conduct the validation referred to in paragraph (1) in the following circumstances–

(a) when any internal risk-measurement model is initially developed and when any significant changes are made to that model;

(b) on a periodic basis, and where there have been significant structural changes in the market or changes to the composition of the portfolio which might lead to the internal risk-measurement model no longer being adequate.

(3) The validation of the internal risk-measurement models of an institution must not be limited to back-testing and P&L attribution requirements, but must, at a minimum, include the following–

(a) tests to verify whether the assumptions made in the internal model are appropriate and do not underestimate or overestimate the risk;

(b) own internal model validation tests, including back-testing in addition to the regulatory back-testing programmes, in relation to the risks and structures of their portfolios;

(c) the use of hypothetical portfolios to ensure that the internal risk-measurement model is able to account for particular structural features that may arise, for example, material basis risks and concentration risk, or the risks associated with the use of proxies.

Calculation of stress scenario risk measure.

325BK.(1) The “stress scenario risk measure” of a given non-modellable risk factor means the loss that is incurred in all trading book positions or non-trading book positions that are subject to foreign exchange or commodity risk of the portfolio which includes that non-modellable risk factor when an extreme scenario of future shock is applied to that risk factor.

(2) Institutions must develop appropriate extreme scenarios of future shock for all non-modellable risk factors, to the satisfaction of the GFSC.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(3) [Not used]

Internal default risk model

Scope of the internal default risk model.

325BL.(1) All the positions of an institution that have been assigned to the trading desks for which the institution has been granted approval as referred to in Article 325AZ(2) are subject to an own funds requirement for default risk where those positions contain at least one risk factor that has been mapped to the broad categories of ‘ equity ’ or ‘ credit spread ’ risk factors in accordance with Article 325BD(1). That own funds requirement, which is incremental to the risks captured by the own funds requirements referred to in Article 325BA(1), is calculated using the institution's internal default risk model. That model which must comply with the requirements laid down in Articles 325BL to 325BP.

(2) For each of the positions referred to in paragraph (1), an institution must identify one issuer of traded debt or equity instruments related to at least one risk factor.

Approval to use an internal default risk model.

325BM.(1) The GFSC, when determining an application to use an internal default risk model to calculate the own funds requirements referred to in Article 325BA(2) for all the trading book positions referred to in Article 325BL that are assigned to a trading desk, must take into account whether the internal default risk model complies with the requirements set out in Articles 325BI, 325BJ, 325BN, 325BO and 325BP.

(2) Where the trading desk of an institution, to which at least one of the trading book positions referred to in Article 325BL has been assigned, does not meet the requirements set out in paragraph (1), the own funds requirements for market risk of all positions in that trading desk are calculated in accordance with the approach set out in Chapter 1A.

Own funds requirements for default risk using an internal default risk model.

325BN.(1) Institutions must calculate the own funds requirements for default risk using an internal default risk model for the portfolio of all trading book positions as referred to in Article 325BL as follows–

(a) the own funds requirements must be equal to a value-at-risk number measuring potential losses in the market value of the portfolio caused by the default of issuers related to those positions at the 99.9% confidence interval over a one-year time horizon;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(b) the potential loss referred to in sub-paragraph (a) means a direct or indirect loss in the market value of a position which was caused by the default of the issuers and which is incremental to any losses already taken into account in the current valuation of the position; the default of the issuers of equity positions must be represented by the value for the issuers' equity prices being set to zero;

(c) institutions must determine default correlations between different issuers on the basis of a conceptually sound methodology, using objective historical data on market credit spreads or equity prices that cover at least a 10 year period that includes the stress period identified by the institution in accordance with Article 325BC(2); the calculation of default correlations between different issuers must be calibrated to a one-year time horizon;

(d) the internal default risk model must be based on a one-year constant position assumption.

(2) Institutions must calculate the own funds requirement for default risk using an internal default risk model as referred to in paragraph (1) on at least a weekly basis.

(3) By way of derogation from paragraph (1)(a) and (c), an institution may replace the one-year time horizon with a time horizon of sixty days for the purpose of calculating the default risk of some or all of the equity positions, where appropriate. In such case, the calculation of default correlations between equity prices and default probabilities must be consistent with a time horizon of sixty days and the calculation of default correlations between equity prices and bond prices must be consistent with a one-year time horizon.

Recognition of hedges in an internal default risk model.

325BO.(1) Institutions may incorporate hedges in their internal default risk model and may net positions where the long positions and short positions relate to the same financial instrument.

(2) In their internal default risk models, institutions may only recognise hedging or diversification effects associated with long and short positions involving different instruments or different securities of the same obligor, as well as long and short positions in different issuers by explicitly modelling the gross long and short positions in the different instruments, including modelling of basis risks between different issuers.

(3) In their internal default risk models, institutions must capture material risks between a hedging instrument and the hedged instrument that could occur during the interval between the maturity of a hedging instrument and the one-year time horizon, as well as the potential for

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

significant basis risks in hedging strategies that arise from differences in the type of product, seniority in the capital structure, internal or external ratings, maturity, vintage and other differences. Institutions must recognise a hedging instrument only to the extent that it can be maintained even as the obligor approaches a credit event or other event.

Particular requirements for an internal default risk model.

325BP.(1) The internal default risk model referred to in Article 325BM(1) must be capable of modelling the default of individual issuers as well as the simultaneous default of multiple issuers, and must take into account the impact of those defaults in the market values of the positions that are included in the scope of that model. For that purpose, the default of each individual issuer must be modelled using two types of systematic risk factors.

(2) The internal default risk model must reflect the economic cycle, including the dependency between recovery rates and the systematic risk factors referred to in paragraph (1).

(3) The internal default risk model must reflect the nonlinear impact of options and other positions with material nonlinear behaviour with respect to price changes. Institutions must also have due regard to the amount of model risk inherent in the valuation and estimation of price risks associated with those products.

(4) The internal default risk model must be based on data that are objective and up-to-date.

(5) To simulate the default of issuers in the internal default risk model, the institution's estimates of default probabilities must meet the following requirements–

(a) the default probabilities must be floored at 0.03%;

(b) the default probabilities must be based on a one-year time horizon, unless stated otherwise in Articles 325BL to 325BP;

(c) the default probabilities must be measured using, solely or in combination with current market prices, data observed during a historical period of at least five years of actual past defaults and extreme declines in market prices equivalent to default events; default probabilities must not be inferred solely from current market prices;

(d) an institution that has been granted approval to estimate default probabilities in accordance with Articles 142 to 150 must use the methodology set out therein to calculate default probabilities;

(e) an institution that has not been granted approval to estimate default probabilities in accordance with Articles 142 to 150 must develop an internal methodology or

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

use external sources to estimate default probabilities; in both situations, the estimates of default probabilities must be consistent with the requirements set out in this Article.

(6) To simulate the default of issuers in the internal default risk model, the institution's estimates of loss given default must meet the following requirements–

(a) the loss given default estimates are floored at 0%;

(b) the loss given default estimates must reflect the seniority of each position;

(c) an institution that has been granted approval to estimate loss given default in accordance with Articles 142 to 1502 must use the methodology set out therein to calculate loss given default estimates;

(d) an institution that has not been granted approval to estimate loss given default in accordance with Articles 142 to 150must develop an internal methodology or use external sources to estimate loss given default; in both situations, the estimates of loss given default must be consistent with the requirements set out in this Article.

(7) As part of the independent review and validation of the internal models that they use for the purposes of this Chapter, including for the risk-measurement system, institutions must–

(a) verify that their approach for the modelling of correlations and price changes is appropriate for their portfolio, including the choice and weights of the systematic risk factors in the model;

(b) perform a variety of stress tests, including sensitivity analyses and scenario analyses, to assess the qualitative and quantitative reasonableness of the internal default risk model, in particular with regard to the treatment of concentrations; and

(c) apply appropriate quantitative validation including relevant internal modelling benchmarks.

The tests referred to in sub-paragraph (b) must not be limited to the range of past events experienced.

(8) The internal default risk model must appropriately reflect issuer concentrations and concentrations that can arise within and across product classes under stressed conditions.

(9) The internal default risk model must be consistent with the institution's internal risk management methodologies for identifying, measuring, and managing trading risks.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(10) Institutions must have clearly defined policies and procedures for determining the default assumptions for correlations between different issuers in accordance with Article 325BN(1)(c) and the preferred choice of method for estimating the default probabilities in paragraph (5)(e) and the loss given default in paragraph (6)(d).

(11) Institutions must document their internal models so that their correlation assumptions and other modelling assumptions are transparent to the GFSC.

(12) [Not used]

CHAPTER 2
OWN FUNDS REQUIREMENTS FOR POSITION RISK

General provisions and specific instruments

Own funds requirements for position risk.

326. The institution's own funds requirement for position risk must be the sum of the own funds requirements for the general and specific risk of its positions in debt and equity instruments. Securitisation positions in the trading book must be treated as debt instruments.

Netting.

327.(1) The absolute value of the excess of an institution's long (short) positions over its short (long) positions in the same equity, debt and convertible issues and identical financial futures, options, warrants and covered warrants must be its net position in each of those different instruments. In calculating the net position, positions in derivative instruments must be treated as laid down in Articles 328 to 330. Institutions' holdings of their own debt instruments are disregarded in calculating specific risk capital requirements under Article 336.

(2) No netting must be allowed between a convertible and an offsetting position in the instrument underlying it, unless the GFSC adopt an approach under which the likelihood of a particular convertible's being converted is taken into account or require an own funds requirement to cover any loss which conversion might entail.

(3) All net positions, irrespective of their signs, must be converted on a daily basis into the institution's reporting currency at the prevailing spot exchange rate before their aggregation.

Interest rate futures and forwards.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

328.(1) Interest-rate futures, forward-rate agreements (FRAs) and forward commitments to buy or sell debt instruments are treated as combinations of long and short positions. A long interest-rate futures position is treated as a combination of a borrowing maturing on the delivery date of the futures contract and a holding of an asset with maturity date equal to that of the instrument or notional position underlying the futures contract in question. Similarly a sold FRA will be treated as a long position with a maturity date equal to the settlement date plus the contract period, and a short position with maturity equal to the settlement date. Both the borrowing and the asset holding must be included in the first category set out in Table 1 in Article 336 in order to calculate the own funds requirement for specific risk for interest-rate futures and FRAs. A forward commitment to buy a debt instrument is treated as a combination of a borrowing maturing on the delivery date and a long (spot) position in the debt instrument itself. The borrowing must be included in the first category set out in Table 1 in Article 336 for purposes of specific risk, and the debt instrument under whichever column is appropriate for it in the same table.

(2) For the purposes of this Article, "long position" means a position in which an institution has fixed the interest rate it will receive at some time in the future, and "short position" means a position in which it has fixed the interest rate it will pay at some time in the future.

Options and warrants.

329.(1) Options and warrants on interest rates, debt instruments, equities, equity indices, financial futures, swaps and foreign currencies are treated as if they were positions equal in value to the amount of the underlying instrument to which the option refers, multiplied by its delta for the purposes of this Chapter. The latter positions may be netted off against any offsetting positions in the identical underlying securities or derivatives. The delta used is that of the exchange concerned. For OTC-options, or where delta is not available from the exchange concerned, the institution may calculate delta itself using an appropriate model, subject to GFSC approval. The GFSC must consider whether the model appropriately estimates the rate of change of the option's or warrant's value with respect to small changes in the market price of the underlying.

(2) Institutions must adequately reflect other risks, apart from the delta risk, associated with options in the own funds requirements.

(3) [Not used]

Swaps.

330. Swaps are treated for interest-rate risk purposes on the same basis as on-balance-sheet instruments. Thus, an interest-rate swap under which an institution receives floating-rate interest and pays fixed-rate interest are treated as equivalent to a long position in a floating-

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

rate instrument of maturity equivalent to the period until the next interest fixing and a short position in a fixed-rate instrument with the same maturity as the swap itself.

Interest rate risk on derivative instruments.

331.(1) Institutions which mark to market and manage the interest-rate risk on the derivative instruments covered in Articles 328 to 330 on a discounted-cash-flow basis may, subject to GFSC approval, use sensitivity models to calculate the positions referred to in those Articles and may use them for any bond which is amortised over its residual life rather than via one final repayment of principal. The GFSC must consider whether these models generate positions which have the same sensitivity to interest-rate changes as the underlying cash flows. This sensitivity is assessed with reference to independent movements in sample rates across the yield curve, with at least one sensitivity point in each of the maturity bands set out in Table 2 in Article 339. The positions must be included in the calculation of own funds requirements for general risk of debt instruments.

(2) Institutions which do not use models under paragraph (1) may, treat as fully offsetting any positions in derivative instruments covered in Articles 328 to 330 which meet the following conditions at least–

(a) the positions are of the same value and denominated in the same currency;

(b) the reference rate (for floating-rate positions) or coupon (for fixed-rate positions) is closely matched;

(c) the next interest-fixing date or, for fixed coupon positions, residual maturity corresponds with the following limits–

(i) less than one month hence– same day;

(ii) between one month and one year hence– within seven days;

(iii) over one year hence– within 30 days.

Credit Derivatives.

332.(1) When calculating the own funds requirement for general and specific risk of the party who assumes the credit risk (the "protection seller"), unless specified differently, the notional amount of the credit derivative contract must be used. Despite the first sentence, the institution may elect to replace the notional value by the notional value plus the net market value change of the credit derivative since trade inception, a net downward change from the protection seller's perspective carrying a negative sign. For the purpose of calculating the specific risk

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

charge, other than for total return swaps, the maturity of the credit derivative contract, rather than the maturity of the obligation, must apply. Positions are determined as follows–

(a) a total return swap creates a long position in the general risk of the reference obligation and a short position in the general risk of a government bond with a maturity equivalent to the period until the next interest fixing and which is assigned a 0% risk weight under Title 2, Chapter 2. It also creates a long position in the specific risk of the reference obligation;

(b) a credit default swap does not create a position for general risk. For the purposes of specific risk, the institution must record a synthetic long position in an obligation of the reference entity, unless the derivative is rated externally and meets the conditions for a qualifying debt item, in which case a long position in the derivative is recorded. If premium or interest payments are due under the product, these cash flows must be represented as notional positions in government bonds;

(c) a single name credit linked note creates a long position in the general risk of the note itself, as an interest rate product. For the purpose of specific risk, a synthetic long position is created in an obligation of the reference entity. An additional long position is created in the issuer of the note. Where the credit linked note has an external rating and meets the conditions for a qualifying debt item, a single long position with the specific risk of the note need only be recorded;

(d) in addition to a long position in the specific risk of the issuer of the note, a multiple name credit linked note providing proportional protection creates a position in each reference entity, with the total notional amount of the contract assigned across the positions according to the proportion of the total notional amount that each exposure to a reference entity represents. Where more than one obligation of a reference entity can be selected, the obligation with the highest risk weighting determines the specific risk;

(e) a first-asset-to-default credit derivative creates a position for the notional amount in an obligation of each reference entity. If the size of the maximum credit event payment is lower than the own funds requirement under the method in the first sentence of this sub-paragraph, the maximum payment amount may be taken as the own funds requirement for specific risk.

A -n-th-asset-to-default credit derivative creates a position for the notional amount in an obligation of each reference entity less the n-1 reference entities with the lowest specific risk own funds requirement. If the size of the maximum credit event payment is lower than the own

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

funds requirement under the method in the first sentence of this sub-paragraph, this amount may be taken as the own funds requirement for specific risk.

Where an n-th-to-default credit derivative is externally rated, the protection seller must calculate the specific risk own funds requirement using the rating of the derivative and apply the respective securitisation risk weights as applicable.

(2) For the party who transfers credit risk (the protection buyer), the positions are determined as the mirror principle of the protection seller, with the exception of a credit linked note (which entails no short position in the issuer). When calculating the own funds requirement for the "protection buyer", the notional amount of the credit derivative contract must be used. Despite the first sentence, the institution may elect to replace the notional value by the notional value plus the net market value change of the credit derivative since trade inception, a net downward change from the protection seller's perspective carrying a negative sign. If at a given moment there is a call option in combination with a step-up, such moment is treated as the maturity of the protection.

(3) Credit derivatives in accordance with Article 338(1) or (3) must be included only in the determination of the specific risk own funds requirement in accordance with Article 338(4).

Securities sold under a repurchase agreement or lent.

333. The transferor of securities or guaranteed rights relating to title to securities in a repurchase agreement and the lender of securities in a securities lending must include these securities in the calculation of its own funds requirement under this Chapter if such securities are trading book positions.

Debt instruments

Net positions in debt instruments.

334. Net positions must be classified according to the currency in which they are denominated and must calculate the own funds requirement for general and specific risk in each individual currency separately.

Cap on the own funds requirement for a net position.

335. The institution may cap the own funds requirement for specific risk of a net position in a debt instrument at the maximum possible default-risk related loss. For a short position, that limit may be calculated as a change in value due to the instrument or, where relevant, the underlying names immediately becoming default risk-free.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Own funds requirement for non-securitisation debt instruments.

336.(1) The institution must assign its net positions in the trading book in instruments that are not securitisation positions as calculated in accordance with Article 327 to the appropriate categories in Table 1 on the basis of their issuer or obligor, external or internal credit assessment, and residual maturity, and then multiply them by the weightings shown in that table. It must sum its weighted positions resulting from the application of this Article regardless of whether they are long or short in order to calculate its own funds requirement against specific risk.

Table 1

Categories	Specific risk own funds requirement
Debt securities which would receive a 0 % risk weight under the Standardised Approach for credit risk.	0 %
Debt securities which would receive a 20 % or 50 % risk weight under the Standardised Approach for credit risk and other qualifying items as defined in paragraph 4.	0,25 % (residual term to final maturity six months or less) 1,00 % (residual term to final maturity greater than six months and up to and including 24 months) 1,60 % (residual term to maturity exceeding 24 months)
Debt securities which would receive a 100 % risk weight under the Standardised Approach for credit risk.	8,00 %
Debt which would receive a 150 % risk weight under the Standardised Approach for credit risk.	12,00 %

(2) For institutions which apply the IRB Approach to the exposure class of which the issuer of the debt instrument forms part, to qualify for a risk weight under the Standardised Approach for credit risk as referred to in paragraph (1), the issuer of the exposure must have an internal rating with a PD equivalent to or lower than that associated with the appropriate credit quality step under the Standardised Approach.

(3) Institutions may calculate the specific risk requirements for any bonds that qualify for a 10% risk weight in accordance with the treatment set out in Article 129(4), (5) and (6) as half of the applicable specific risk own funds requirement for the second category in Table 1.

(4) Other qualifying items are–

(a) long and short positions in assets for which a credit assessment by a nominated ECAI is not available and which meet all of the following conditions–

they are considered by the institution concerned to be sufficiently liquid;

their investment quality is, according to the institution's own discretion, at least equivalent to that of the assets referred to under Table 1 second row;

they are listed on at least one regulated market in Gibraltar or on a stock exchange in a third country if the exchange is recognised by the GFSC;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(b) long and short positions in assets issued by institutions subject to the own funds requirements set out in these Standards which are considered by the institution concerned to be sufficiently liquid and whose investment quality is, according to the institution's own discretion, at least equivalent to that of the assets referred to under Table 1 second row;

(c) securities issued by institutions that are deemed to be of equivalent, or higher, credit quality than those associated with credit quality step 2 under the Standardised Approach for credit risk of exposures to institutions and that are subject to supervisory and regulatory arrangements comparable to those under these Standards and the CICR Regulations.

Institutions that make use of sub-paragraphs (a) or (b) must have a documented methodology in place to assess whether assets meet the requirements in those sub-paragraphs and must notify this methodology to the GFSC.

Own funds requirement for securitisation instruments.

337.(1) For instruments in the trading book that are securitisation positions, the institution must weight the net positions as calculated in accordance with Article 327(1) with 8% of the risk weight the institution would apply to the position in its non-trading book according to Articles 247 to 270A.

(2) When determining risk weights for the purposes of paragraph (1), estimates of PD and LGD may be determined based on estimates that are derived from an internal incremental default and migration risk model (IRC model) of an institution that has been granted approval to use an internal model for specific risk of debt instruments. The latter alternative may be used only subject to GFSC approval, which must consider whether those estimates meet the quantitative requirements for the IRB Approach set out in Chapter 3 of Title 2.

The GFSC may issue guidance on the use of estimates of PD and LGD as inputs when those estimates are based on an IRC model.

(3) For securitisation positions that are subject to an additional risk weight in accordance with Article 247(6), 8% of the total risk weight must be applied.

(4) The institution must sum its weighted positions resulting from the application of paragraphs (1), (2) and (3) regardless of whether they are long or short, in order to calculate its own funds requirement against specific risk, except for securitisation positions subject to Article 338(4).

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(5) Where an originator institution of a traditional securitisation does not meet the conditions for significant risk transfer set out in Article 244, the originator institution must include the exposures underlying the securitisation in its calculation of own funds requirement as if those exposures had not been securitised.

Where an originator institution of a synthetic securitisation does not meet the conditions for significant risk transfer set out in Article 245, the originator institution must include the exposures underlying the securitisation in its calculation of own funds requirements as if those exposures had not been securitised and must ignore the effect of the synthetic securitisation for credit protection purposes.

Own funds requirement for the correlation trading portfolio.

338.(1) The correlation trading portfolio must consist of securitisation positions and n-th-to-default credit derivatives that meet all of the following criteria–

(a) the positions are neither re-securitisation positions, nor options on a securitisation tranche, nor any other derivatives of securitisation exposures that do not provide a pro-rata share in the proceeds of a securitisation tranche;

(b) all reference instruments are either of the following–

(i) single-name instruments, including single-name credit derivatives, for which a liquid two-way market exists;

(ii) commonly-traded indices based on those reference entities.

A two-way market is deemed to exist where there are independent bona fide offers to buy and sell so that a price reasonably related to the last sales price or current bona fide competitive bid and offer quotations can be determined within one day and settled at such price within a relatively short time conforming to trade custom.

(2) Positions which reference any of the following must not be part of the correlation trading portfolio–

(a) an underlying that is capable of being assigned to the exposure class “retail exposures” or to the exposure class “exposures secured by mortgages on immovable property” under the Standardised Approach for credit risk in an institution's non-trading book;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(b) a claim on a special purpose entity, collateralised, directly or indirectly, by a position that would itself not be eligible for inclusion in the correlation trading portfolio in accordance with paragraph (1) and this paragraph.

(3) An institution may include in the correlation trading portfolio positions which are neither securitisation positions nor n-th-to-default credit derivatives but which hedge other positions of that portfolio, if a liquid two-way market as described in the last sub-paragraph of paragraph (1) exists for the instrument or its underlyings.

(4) An institution must determine the larger of the following amounts as the specific risk own funds requirement for the correlation trading portfolio–

(a) the total specific risk own funds requirement that would apply just to the net long positions of the correlation trading portfolio;

(b) the total specific risk own funds requirement that would apply just to the net short positions of the correlation trading portfolio.

Maturity-based calculation of general risk.

339.(1) In order to calculate own funds requirements against general risk all positions must be weighted according to maturity as explained in paragraph (2) in order to compute the amount of own funds required against them. This requirement must be reduced when a weighted position is held alongside an opposite weighted position within the same maturity band. A reduction in the requirement must also be made when the opposite weighted positions fall into different maturity bands, with the size of this reduction depending both on whether the two positions fall into the same zone, or not, and on the particular zones they fall into.

(2) The institution must assign its net positions to the appropriate maturity bands in column 2 or 3, as appropriate, in Table 2 in paragraph (4). It must do so on the basis of residual maturity in the case of fixed-rate instruments and on the basis of the period until the interest rate is next set in the case of instruments on which the interest rate is variable before final maturity. It must also distinguish between debt instruments with a coupon of 3% or more and those with a coupon of less than 3% and thus allocate them to column 2 or column 3 in Table 2. It must then multiply each of them by the weighing for the maturity band in question in column 4 in Table 2.

(3) The institution must then work out the sum of the weighted long positions and the sum of the weighted short positions in each maturity band. The amount of the former which are matched by the latter in a given maturity band must be the matched weighted position in that band, while the residual long or short position must be the unmatched weighted position for

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

the same band. The total of the matched weighted positions in all bands must then be calculated.

(4) The institution must compute the totals of the unmatched weighted long positions for the bands included in each of the zones in Table 2 in order to derive the unmatched weighted long position for each zone. Similarly, the sum of the unmatched weighted short positions for each band in a particular zone must be summed to compute the unmatched weighted short position for that zone. That part of the unmatched weighted long position for a given zone that is matched by the unmatched weighted short position for the same zone must be the matched weighted position for that zone. That part of the unmatched weighted long or unmatched weighted short position for a zone that cannot be thus matched must be the unmatched weighted position for that zone.

Table 2

Zone	Maturity band		Weighting (in %)	Assumed interest rate change (in %)
	Coupon of 3 % or more	Coupon of less than 3 %		
One	0 ≤ 1 month	0 ≤ 1 month	0,00	—
	> 1 ≤ 3 months	> 1 ≤ 3 months	0,20	1,00
	> 3 ≤ 6 months	> 3 ≤ 6 months	0,40	1,00
	> 6 ≤ 12 months	> 6 ≤ 12 months	0,70	1,00
Two	> 1 ≤ 2 years	> 1,0 ≤ 1,9 years	1,25	0,90
	> 2 ≤ 3 years	> 1,9 ≤ 2,8 years	1,75	0,80
	> 3 ≤ 4 years	> 2,8 ≤ 3,6 years	2,25	0,75
Three	> 4 ≤ 5 years	> 3,6 ≤ 4,3 years	2,75	0,75
	> 5 ≤ 7 years	> 4,3 ≤ 5,7 years	3,25	0,70
	> 7 ≤ 10 years	> 5,7 ≤ 7,3 years	3,75	0,65
	> 10 ≤ 15 years	> 7,3 ≤ 9,3 years	4,50	0,60
	> 15 ≤ 20 years	> 9,3 ≤ 10,6 years	5,25	0,60
	> 20 years	> 10,6 ≤ 12,0 years	6,00	0,60
		> 12,0 ≤ 20,0 years	8,00	0,60
		> 20 years	12,50	0,60

(5) The amount of the unmatched weighted long or short position in zone one which is matched by the unmatched weighted short or long position in zone two must then be the matched weighted position between zones one and two. The same calculation must then be undertaken with regard to that part of the unmatched weighted position in zone two which is left over and the unmatched weighted position in zone three in order to calculate the matched weighted position between zones two and three.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(6) The institution may reverse the order in paragraph (5) so as to calculate the matched weighted position between zones two and three before calculating that position between zones one and two.

(7) The remainder of the unmatched weighted position in zone one must then be matched with what remains of that for zone three after the latter's matching with zone two in order to derive the matched weighted position between zones one and three.

(8) Residual positions, following the three separate matching calculations in paragraphs (5), (6) and (7) must be summed.

(9) The institution's own funds requirement must be calculated as the sum of–

(a) 10% of the sum of the matched weighted positions in all maturity bands;

(b) 40% of the matched weighted position in zone one;

(c) 30% of the matched weighted position in zone two;

(d) 30% of the matched weighted position in zone three;

(e) 40% of the matched weighted position between zones one and two and between zones two and three;

(f) 150% of the matched weighted position between zones one and three;

(g) 100% of the residual unmatched weighted positions.

Duration-based calculation of general risk.

340.(1) Institutions may use an approach for calculating the own funds requirement for the general risk on debt instruments which reflects duration, instead of the approach set out in Article 339, if the institution does so on a consistent basis.

(2) Under the duration-based approach referred to in paragraph (1), the institution must take the market value of each fixed-rate debt instrument and hence calculate its yield to maturity, which is implied discount rate for that instrument. In the case of floating-rate instruments, the institution must take the market value of each instrument and hence calculate its yield on the assumption that the principal is due when the interest rate can next be changed.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(3) The institution must then calculate the modified duration of each debt instrument on the basis of the following formula–

$$\text{modified duration} = \frac{D}{1+R}$$

where–

D = duration calculated according to the following formula–

$$D = \frac{\sum_{t=1}^{M} \frac{t \times C_t}{(1+R)^t}}{\sum_{t=1}^{M} \frac{C_t}{(1+R)^t}}$$

where–

R = yield to maturity;

C_t = cash payment in time t;

M = total maturity.

Correction must be made to the calculation of the modified duration for debt instruments which are subject to prepayment risk.

(4) The institution must then allocate each debt instrument to the appropriate zone in Table 3. It must do so on the basis of the modified duration of each instrument.

Table 3

Zone	Modified duration (in years)	Assumed interest (change in%)
One	> 0 ≤ 1.0	1.0
Two	> 1.0 ≤ 3.6	0.85
Three	> 3.6	0.7

(5) The institution must then calculate the duration-weighted position for each instrument by multiplying its market price by its modified duration and by the assumed interest-rate change for an instrument with that particular modified duration (see column 3 in Table 3).

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(6) The institution must calculate its duration-weighted long and its duration-weighted short positions within each zone. The amount of the former which are matched by the latter within each zone must be the matched duration-weighted position for that zone.

The institution must then calculate the unmatched duration-weighted positions for each zone. It must then follow the procedures laid down for unmatched weighted positions in Article 339(5) to (8).

(7) The institution's own funds requirement must then be calculated as the sum of the following–

(a) 2% of the matched duration-weighted position for each zone;

(b) 40% of the matched duration-weighted positions between zones one and two and between zones two and three;

(c) 150% of the matched duration-weighted position between zones one and three;

(d) 100% of the residual unmatched duration-weighted positions.

Equities

Net positions in equity instruments.

341.(1) The institution must separately sum all its net long positions and all its net short positions in accordance with Article 327. The sum of the absolute values of the two figures must be its overall gross position.

(2) The institution must calculate, separately for each market, the difference between the sum of the net long and the net short positions. The sum of the absolute values of those differences must be its overall net position.

(3) [Not used]

Specific risk of equity instruments.

342. The institution must multiply its overall gross position by 8% in order to calculate its own funds requirement against specific risk.

General risk of equity instruments.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

343. The own funds requirement against general risk must be the institution's overall net position multiplied by 8%.

Stock indices.

344.(1) [Not used]

(2) [Not used]

(3) Stock-index futures, the delta-weighted equivalents of options in stock-index futures and stock indices collectively referred to hereafter as “stock-index futures”, may be broken down into positions in each of their constituent equities. These positions may be treated as underlying positions in the equities in question, and may, be netted against opposite positions in the underlying equities themselves. Institutions must notify the GFSC of the use they make of that treatment.

(4) Where a stock-index future is not broken down into its underlying positions, it must be treated as if it were an individual equity. However, the specific risk on this individual equity can be ignored if the stock-index future in question is exchange traded and represents a relevant appropriately diversified index.

Underwriting

Reduction of net positions.

345.(1) In the case of the underwriting of debt and equity instruments, an institution may use the following procedure in calculating its own funds requirements. The institution must first calculate the net positions by deducting the underwriting positions which are subscribed or sub-underwritten by third parties on the basis of formal agreements. The institution must then reduce the net positions by the reduction factors in Table 4 and calculate its own funds requirements using the reduced underwriting positions.

Table 4

working day 0:	100 %
working day 1:	90 %
working days 2 to 3:	75 %
working day 4:	50 %
working day 5:	25 %
after working day 5:	0 %.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

"Working day zero" must be the working day on which the institution becomes unconditionally committed to accepting a known quantity of securities at an agreed price.

(2) The institutions must notify to the GFSC the use they make of paragraph (1).

Specific risk own funds requirements for positions hedged by credit derivatives

Allowance for hedges by credit derivatives.

346.(1) An allowance may be given for hedges provided by credit derivatives, in accordance with the principles set out in paragraphs (2) to (6).

(2) Institutions must treat the position in the credit derivative as one "leg" and the hedged position that has the same nominal, or, where applicable, notional amount, as the other "leg".

(3) Full allowance must be given when the values of the two legs always move in the opposite direction and broadly to the same extent. This will be the case in the following situations–

(a) the two legs consist of completely identical instruments;

(b) a long cash position is hedged by a total rate of return swap (or vice versa) and there is an exact match between the reference obligation and the underlying exposure (i.e., the cash position). The maturity of the swap itself may be different from that of the underlying exposure.

In these situations, a specific risk own funds requirement must not be applied to either side of the position.

(4) An 80% offset will be applied when the values of the two legs always move in the opposite direction and where there is an exact match in terms of the reference obligation, the maturity of both the reference obligation and the credit derivative, and the currency of the underlying exposure. In addition, key features of the credit derivative contract must not cause the price movement of the credit derivative to materially deviate from the price movements of the cash position. To the extent that the transaction transfers risk, an 80% specific risk offset will be applied to the side of the transaction with the higher own funds requirement, while the specific risk requirements on the other side must be zero.

(5) Partial allowance may be given, absent the situations in paragraphs (3) and (4), in the following situations–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) the position falls under paragraph (3)(b) but there is an asset mismatch between the reference obligation and the underlying exposure. However, the positions meet the following requirements–

(i) the reference obligation ranks *pari passu* with or is junior to the underlying obligation;

(ii) the underlying obligation and reference obligation share the same obligor and have legally enforceable cross-default or cross-acceleration clauses;

(b) the position falls under paragraph (3)(a) or paragraph (4) but there is a currency or maturity mismatch between the credit protection and the underlying asset. Such currency mismatch must be included in the own funds requirement for foreign exchange risk;

(c) the position falls under paragraph (4) but there is an asset mismatch between the cash position and the credit derivative. However, the underlying asset is included in the (deliverable) obligations in the credit derivative documentation.

In order to give partial allowance, rather than adding the specific risk own funds requirements for each side of the transaction, only the higher of the two own funds requirements must apply.

(6) In all situations not falling under paragraphs (3) to (5), an own funds requirement for specific risk must be calculated for both sides of the positions separately.

Allowance for hedges by first and nth-to default credit derivatives.

347. In the case of first-to-default credit derivatives and nth-to-default credit derivatives, the following treatment applies for the allowance to be given in accordance with Article 346–

(a) where an institution obtains credit protection for a number of reference entities underlying a credit derivative under the terms that the first default among the assets must trigger payment and that this credit event must terminate the contract, the institution may offset specific risk for the reference entity to which the lowest specific risk percentage charge among the underlying reference entities applies in accordance with Table 1 in Article 336;

(b) where the nth default among the exposures triggers payment under the credit protection, the protection buyer may only offset specific risk if protection has also been obtained for defaults 1 to n-1 or when n-1 defaults have already occurred. In such cases, the methodology set out in sub-paragraph (a) for first-to-default credit derivatives must be followed appropriately amended for nth-to-default products.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Own funds requirements for CIUs

Own funds requirements for CIUs.

348.(1) Without prejudice to other provisions in Articles 348 to 350, positions in CIUs are subject to an own funds requirement for position risk, comprising specific and general risk, of 32%. Without prejudice to Article 353 taken together with the amended gold treatment set out in Article 352(4) and Article 367(2)(b) positions in CIUs must be subject to an own funds requirement for position risk, comprising specific and general risk, and foreign-exchange risk of 40%.

(2) Unless noted otherwise in Article 350, no netting is permitted between the underlying investments of a CIU and other positions held by the institution.

General criteria for CIUs.

349. CIUs must be eligible for the approach set out in Article 350, where all the following conditions are met–

(a) the CIU's prospectus or equivalent document must include all of the following–

(i) the categories of assets in which the CIU is authorised to invest;

(ii) where investment limits apply, the relative limits and the methodologies to calculate them;

(iii) where leverage is allowed, the maximum level of leverage;

(iv) where concluding OTC financial derivatives transactions or repurchase transactions or securities borrowing or lending is allowed, a policy to limit counterparty risk arising from these transactions;

(b) the business of the CIU must be reported in half-yearly and annual reports to enable an assessment to be made of the assets and liabilities, income and operations over the reporting period;

(c) the shares or units of the CIU must be redeemable in cash, out of the undertaking's assets, on a daily basis at the request of the unit holder;

(d) investments in the CIU must be segregated from the assets of the CIU manager;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(e) there must be adequate risk assessment of the CIU, by the investing institution;

(f) CIUs must be managed by persons supervised in accordance with the Financial Services (UCITS) Regulations 2020 or equivalent legislation.

Specific methods for CIUs.

350.(1) Where the institution is aware of the underlying investments of the CIU on a daily basis, the institution may look through to those underlying investments in order to calculate the own funds requirements for position risk, comprising specific and general risk. Under such an approach, positions in CIUs must be treated as positions in the underlying investments of the CIU. Netting must be permitted between positions in the underlying investments of the CIU and other positions held by the institution, if the institution holds a sufficient quantity of shares or units to allow for redemption/creation in exchange for the underlying investments.

(2) Institutions may calculate the own funds requirements for position risk, comprising specific and general risk, for positions in CIUs by assuming positions representing those necessary to replicate the composition and performance of the externally generated index or fixed basket of equities or debt securities referred to in sub-paragraph (a), subject to the following conditions–

(a) the purpose of the CIU's mandate is to replicate the composition and performance of an externally generated index or fixed basket of equities or debt securities;

(b) a minimum correlation coefficient between daily returns on the CIU and the index or basket of equities or debt securities it tracks of 0.9 can be clearly established over a minimum period of six months.

(3) Where the institution is not aware of the underlying investments of the CIU on a daily basis, the institution may calculate the own funds requirements for position risk, comprising specific and general risk, subject to the following conditions–

(a) it will be assumed that the CIU first invests to the maximum extent allowed under its mandate in the asset classes attracting the highest own funds requirement for specific and general risk separately, and then continues making investments in descending order until the maximum total investment limit is reached. The position in the CIU will be treated as a direct holding in the assumed position;

(b) institutions must take account of the maximum indirect exposure that they could achieve by taking leveraged positions through the CIU when calculating their own funds requirement for specific and general risk separately, by proportionally

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

increasing the position in the CIU up to the maximum exposure to the underlying investment items resulting from the mandate;

(c) if the own funds requirement for specific and general risk together in accordance with this paragraph exceed that set out in Article 348(1) the own funds requirement must be capped at that level.

(4) Institutions may rely on the following third parties to calculate and report own funds requirements for position risk for positions in CIUs falling under paragraphs (1) to (4), in accordance with the methods set out in this Chapter–

(a) the depository of the CIU if the CIU exclusively invests in securities and deposits all securities at this depository;

(b) for other CIUs, the CIU management company, if the CIU management company meets the criteria set out in Article 132(3)(a).

The correctness of the calculation must be confirmed by an external auditor.

CHAPTER 3
OWN FUNDS REQUIREMENTS FOR FOREIGN-EXCHANGE RISK

De minimis and weighting for foreign exchange risk.

351. If the sum of an institution's overall net foreign-exchange position and its net gold position, calculated in accordance with the procedure set out in Article 352, including for any foreign exchange and gold positions for which own funds requirements are calculated using an internal model, exceeds 2% of its total own funds, the institution must calculate an own funds requirement for foreign exchange risk. The own funds requirement for foreign exchange risk must be the sum of its overall net foreign-exchange position and its net gold position in the reporting currency, multiplied by 8%.

Calculation of the overall net foreign exchange position.

352.(1) The institution's net open position in each currency (including the reporting currency) and in gold must be calculated as the sum of the following elements (positive or negative)–

(a) the net spot position (i.e. all asset items less all liability items, including accrued interest, in the currency in question or, for gold, the net spot position in gold);

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(b) the net forward position, which are all amounts to be received less all amounts to be paid under forward exchange and gold transactions, including currency and gold futures and the principal on currency swaps not included in the spot position;

(c) irrevocable guarantees and similar instruments that are certain to be called and likely to be irrecoverable;

(d) the net delta, or delta-based, equivalent of the total book of foreign-currency and gold options;

(e) the market value of other options.

The delta used for purposes of sub-paragraph (d) must be that of the exchange concerned. For OTC options, or where delta is not available from the exchange concerned, the institution may calculate delta itself using an appropriate model, subject to GFSC approval. The GFSC must consider whether the model appropriately estimates the rate of change of the option's or warrant's value with respect to small changes in the market price of the underlying.

The institution may include net future income/expenses not yet accrued but already fully hedged if it does so consistently.

The institution may break down net positions in composite currencies into the component currencies in accordance with the quotas in force.

(2) Any positions which an institution has deliberately taken in order to hedge against the adverse effect of the exchange rate on its ratios in accordance with Article 92(1) may, subject to GFSC approval, be excluded from the calculation of net open currency positions. Such positions must be of a non-trading or structural nature and any variation of the terms of their exclusion, subject to separate GFSC approval. The same treatment subject to the same conditions may be applied to positions which an institution has which relate to items that are already deducted in the calculation of own funds.

(3) An institution may use the net present value when calculating the net open position in each currency and in gold if the institution applies this approach consistently.

(4) Net short and long positions in each currency other than the reporting currency and the net long or short position in gold must be converted at spot rates into the reporting currency. They must then be summed separately to form the total of the net short positions and the total of the net long positions respectively. The higher of these two totals must be the institution's overall net foreign-exchange position.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(5) Institutions must adequately reflect other risks associated with options, apart from the delta risk, in the own funds requirements.

(6) [Not used]

Foreign exchange risk of CIUs.

353.(1) For the purposes of Article 352, in respect of CIUs the actual foreign exchange positions of the CIU must be taken into account.

(2) Institutions may rely on the following third parties' reporting of the foreign exchange positions in the CIU–

(a) the depository institution of the CIU if the CIU exclusively invests in securities and deposits all securities at this depository institution;

(b) for other CIUs, the CIU management company, if the CIU management company meets the criteria set out in Article 132(3)(a).

The correctness of the calculation must be confirmed by an external auditor.

(3) Where an institution is not aware of the foreign exchange positions in a CIU, it is assumed that the CIU is invested up to the maximum extent allowed under the CIU's mandate in foreign exchange and institutions must, for trading book positions, take account of the maximum indirect exposure that they could achieve by taking leveraged positions through the CIU when calculating their own funds requirement for foreign exchange risk. This is done by proportionally increasing the position in the CIU up to the maximum exposure to the underlying investment items resulting from the investment mandate. The assumed position of the CIU in foreign exchange is treated as a separate currency according to the treatment of investments in gold, subject to the addition of the total long position to the total long open foreign exchange position and the total short position to the total short open foreign exchange position where the direction of the CIU's investment is available. No netting is allowed between such positions prior to the calculation.

Closely correlated currencies.

354.(1) Institutions may provide lower own funds requirements against positions in relevant closely correlated currencies. A pair of currencies is deemed to be closely correlated only if the likelihood of a loss — calculated on the basis of daily exchange-rate data for the preceding three or five years — occurring on equal and opposite positions in such currencies over the following 10 working days, which is 4% or less of the value of the matched position in question (valued in terms of the reporting currency) has a probability of at least 99%, when an

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

observation period of three years is used, and 95%, when an observation period of five years is used. The own-funds requirement on the matched position in two closely correlated currencies must be 4% multiplied by the value of the matched position.

(2) In calculating the requirements of this Chapter, institutions may disregard positions in currencies, which are subject to a legally binding intergovernmental agreement to limit its variation relative to other currencies covered by the same agreement. Institutions must calculate their matched positions in such currencies and subject them to an own funds requirement no lower than half of the maximum permissible variation laid down in the intergovernmental agreement in question in respect of the currencies concerned.

(3) to (4) [Not used]

(5) Only the unmatched positions in currencies referred to in this Article must be incorporated into the overall net open position in accordance with Article 352(4).

(6) [Not used]

CHAPTER 4
OWN FUNDS REQUIREMENTS FOR COMMODITIES RISK

Choice of method for commodities risk.

355. Subject to Articles 356 to 358, institutions must calculate the own funds requirement for commodities risk with one of the methods set out in Article 359, 360 or 361.

Ancillary commodities business.

356.(1) Institutions with ancillary agricultural commodities business may determine the own funds requirements for their physical commodity stock at the end of each year for the following year where all of the following conditions are met–

(a) at any time of the year it holds own funds for this risk which are not lower than the average own funds requirement for that risk estimated on a conservative basis for the coming year;

(b) it estimates on a conservative basis the expected volatility for the figure calculated under sub-paragraph (a);

(c) its average own funds requirement for this risk does not exceed 5% of its own funds or €1 million and, taking into account the volatility estimated in accordance

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

with sub-paragraph (b), the expected peak own funds requirements do not exceed 6.5% of its own funds;

(d) the institution monitors on an ongoing basis whether the estimates carried out under sub-paragraphs (a) and (b) still reflect the reality.

(2) Institutions must notify to the GFSC the use they make of the option provided in paragraph (1).

Positions in commodities.

357.(1) Each position in commodities or commodity derivatives must be expressed in terms of the standard unit of measurement. The spot price in each commodity must be expressed in the reporting currency.

(2) Positions in gold or gold derivatives must be considered as being subject to foreign-exchange risk and treated in accordance with Chapter 3 or 5, as appropriate, for the purpose of calculating commodities risk.

(3) For the purpose of Article 360(1), the excess of an institution's long positions over its short positions, or vice versa, in the same commodity and identical commodity futures, options and warrants must be its net position in each commodity. Derivative instruments are treated, as laid down in Article 358, as positions in the underlying commodity.

(4) For the purposes of calculating a position in a commodity, the following positions are treated as positions in the same commodity–

(a) positions in different sub-categories of commodities in cases where the sub-categories are deliverable against each other;

(b) positions in similar commodities if they are close substitutes and where a minimum correlation of 0.9 between price movements can be clearly established over a minimum period of one year.

Particular instruments.

358.(1) Commodity futures and forward commitments to buy or sell individual commodities must be incorporated in the measurement system as notional amounts in terms of the standard unit of measurement and assigned a maturity with reference to expiry date.

(2) Commodity swaps where one side of the transaction is a fixed price and the other the current market price are treated, as a series of positions equal to the notional amount of the

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

contract, with, where relevant, one position corresponding with each payment on the swap and slotted into the maturity bands in Article 359(1). The positions must be long positions if the institution is paying a fixed price and receiving a floating price and short positions if the institution is receiving a fixed price and paying a floating price. Commodity swaps where the sides of the transaction are in different commodities are to be reported in the relevant reporting ladder for the maturity ladder approach.

(3) Options and warrants on commodities or on commodity derivatives are treated as if they were positions equal in value to the amount of the underlying to which the option refers, multiplied by its delta for the purposes of this Chapter. The latter positions may be netted off against any offsetting positions in the identical underlying commodity or commodity derivative. The delta used must be that of the exchange concerned. For OTC options, or where delta is not available from the exchange concerned the institution may calculate delta itself using an appropriate model, subject to GFSC approval. The GFSC must consider whether the model appropriately estimates the rate of change of the option's or warrant's value with respect to small changes in the market price of the underlying.

Institutions must adequately reflect other risks associated with options, apart from the delta risk, in the own funds requirements.

(4) [Not used]

(5) Where an institution is either of the following, it must include the commodities concerned in the calculation of its own funds requirement for commodities risk–

(a) the transferor of commodities or guaranteed rights relating to title to commodities in a repurchase agreement;

(b) the lender of commodities in a commodities lending agreement.

Maturity ladder approach.

359.(1) The institution must use a separate maturity ladder in line with Table 1 for each commodity. All positions in that commodity must be assigned to the appropriate maturity bands. Physical stocks must be assigned to the first maturity band between 0 and up to and including 1 month.

Table 1

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Maturity band (1)	Spread rate (in %) (2)
0 ≤ 1 month	1,50
> 1 ≤ 3 months	1,50
> 3 ≤ 6 months	1,50
> 6 ≤ 12 months	1,50
> 1 ≤ 2 years	1,50
> 2 ≤ 3 years	1,50
> 3 years	1,50

(2) Positions in the same commodity may be offset and assigned to the appropriate maturity bands on a net basis for the following–

(a) positions in contracts maturing on the same date;

(b) positions in contracts maturing within 10 days of each other if the contracts are traded on markets which have daily delivery dates.

(3) The institution must then calculate the sum of the long positions and the sum of the short positions in each maturity band. The amount of the former which are matched by the latter in a given maturity band must be the matched positions in that band, while the residual long or short position must be the unmatched position for the same band.

(4) That part of the unmatched long position for a given maturity band that is matched by the unmatched short position, or vice versa, for a maturity band further out must be the matched position between two maturity bands. That part of the unmatched long or unmatched short position that cannot be thus matched must be the unmatched position.

(5) The institution's own funds requirement for each commodity is calculated on the basis of the relevant maturity ladder as the sum of the following–

(a) the sum of the matched long and short positions, multiplied by the appropriate spread rate as indicated in the second column of Table 1 for each maturity band and by the spot price for the commodity;

(b) the matched position between two maturity bands for each maturity band into which an unmatched position is carried forward, multiplied by 0.6%, which is the carry rate and by the spot price for the commodity;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(c) the residual unmatched positions, multiplied by 15% which is the outright rate and by the spot price for the commodity.

(6) The institution's overall own funds requirement for commodities risk is calculated as the sum of the own funds requirements calculated for each commodity in accordance with paragraph (5).

Simplified approach.

360.(1) The institution's own funds requirement for each commodity is calculated as the sum of the following–

(a) 15% of the net position, long or short, multiplied by the spot price for the commodity;

(b) 3% of the gross position, long plus short, multiplied by the spot price for the commodity.

(2) The institution's overall own funds requirement for commodities risk is calculated as the sum of the own funds requirements calculated for each commodity in accordance with paragraph (1).

Extended maturity ladder approach.

361. Institutions may use the minimum spread, carry and outright rates set out in the following Table 2 instead of those indicated in Article 359 if the institutions–

(a) undertake significant commodities business;

(b) have an appropriately diversified commodities portfolio;

(c) are not yet in a position to use internal models for the purpose of calculating the own funds requirement for commodities risk.

Table 2

	Precious metals (except gold)	Base metals	Agricultural products (softs)	Other, including energy products
Spread rate (%)	1,0	1,2	1,5	1,5
Carry rate (%)	0,3	0,5	0,6	0,6
Outright rate (%)	8	10	12	15

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Institutions must notify the use they make of this Article to the GFSC together with evidence of their efforts to implement an internal model for the purpose of calculating the own funds requirement for commodities risk.

CHAPTER 5
USE OF INTERNAL MODELS TO CALCULATE OWN FUNDS REQUIREMENTS

Approval and own funds requirements

Specific and general risks.

362. Position risk on a traded debt instrument or equity instrument or derivative thereof may be divided into two components for purposes of this Chapter. The first must be its specific risk component and must encompass the risk of a price change in the instrument concerned due to factors related to its issuer or, in the case of a derivative, the issuer of the underlying instrument. The general risk component must encompass the risk of a price change in the instrument due in the case of a traded debt instrument or debt derivative to a change in the level of interest rates or in the case of an equity or equity derivative to a broad equity-market movement unrelated to any specific attributes of individual securities.

Approval to use internal models.

363.(1) The GFSC must consider an institution's compliance with the requirements of Articles 365 to 376 as relevant, before granting approval to institutions to calculate their own funds requirements for one or more of the following risk categories by using their internal models instead of or in combination with the methods in Chapters 2 to 4–

(a) general risk of equity instruments;

(b) specific risk of equity instruments;

(c) general risk of debt instruments;

(d) specific risk of debt instruments;

(e) foreign-exchange risk;

(f) commodities risk.

(2) For risk categories for which the institution has not been granted the approval referred to in paragraph (1) to use its internal models, that institution must continue to calculate own funds

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

requirements in accordance with those Chapters 2, 3 and 4 as relevant. GFSC approval for the use of internal models must be required for each risk category and must be granted only if the internal model covers a significant share of the positions of a certain risk category.

(3) Material changes to the use of internal models that the institution has received approval to use, the extension of the use of internal models that the institution has received approval to use, in particular to additional risk categories, and the initial calculation of stressed value-at-risk in accordance with Article 365(2) require a separate permission by the GFSC.

Institutions must notify the GFSC of all other extensions and changes to the use of those internal models that the institution has received approval to use.

(4) [Not used]

Own funds requirements when using internal models.

364.(1) Each institution using an internal model must fulfil, in addition to own funds requirements calculated in accordance with Chapters 2, 3 and 4 for those risk categories for which approval to use an internal model has not been granted, an own funds requirement expressed as the sum of sub-paragraphs (a) and (b) –

(a) the higher of the following values–

(i) its previous day's value-at-risk number calculated in accordance with Article 365(1) (VaR t-1);

(ii) an average of the daily value-at-risk numbers calculated in accordance with Article 365(1) on each of the preceding sixty business days (VaR avg), multiplied by the multiplication factor (m c) in accordance with Article 366;

(b) the higher of the following values–

(i) its latest available stressed-value-at-risk number calculated in accordance with Article 365(2) (sVaR t-1); and

(ii) an average of the stressed value-at-risk numbers calculated in the manner and frequency specified in Article 365(2) during the preceding sixty business days (sVaR avg), multiplied by the multiplication factor (m s) in accordance with Article 366;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(2) Institutions that use an internal model to calculate their own funds requirement for specific risk of debt instruments must fulfil an additional own funds requirement expressed as the sum of the following sub-paragraphs (a) and (b) –

(a) the own funds requirement calculated in accordance with Article 337 and 338 for the specific risk of securitisation positions and nth to default credit derivatives in the trading book with the exception of those incorporated in an own funds requirement for the specific risk of the correlation trading portfolio in accordance with Article 377 and, where applicable, the own funds requirement for specific risk in accordance with Articles 348 to 350, for those positions in CIUs for which neither the conditions in Article 350(1) nor Article 350(2) are fulfilled;

(b) the higher of–

(i) the most recent risk number for the incremental default and migration risk calculated in accordance with Articles 370 and 371;

(ii) the average of this number over the preceding 12 weeks.

(3) Institutions that have a correlation trading portfolio, which meets the requirements in Article 338(1) to (3), may fulfil an own funds requirement on the basis of Article 377 instead of Article 338(4), calculated as the higher of the following–

(a) the most recent risk number for the correlation trading portfolio calculated in accordance with Article 377;

(b) the average of this number over the preceding 12-weeks;

(c) 8% of the own funds requirement that would, at the time of calculation of the most recent risk number referred to in sub-paragraph (a), be calculated in accordance with Article 338(4) for all those positions incorporated into the internal model for the correlation trading portfolio.

General requirements

VaR and stressed VaR Calculation.

365.(1) The calculation of the value-at-risk number referred to in Article 364 is subject to the following requirements–

(a) daily calculation of the value-at-risk number;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(b) a 99th percentile, one-tailed confidence interval;

(c) a 10-day holding period;

(d) an effective historical observation period of at least one year except where a shorter observation period is justified by a significant upsurge in price volatility;

(e) at least monthly data set updates.

The institution may use value-at-risk numbers calculated according to shorter holding periods than 10 days scaled up to 10 days by an appropriate methodology that is reviewed periodically.

(2) In addition, the institution must at least weekly calculate a ‘ stressed value-at-risk ’ of the current portfolio, in accordance with the requirements set out in the first paragraph, with value-at-risk model inputs calibrated to historical data from a continuous 12-month period of significant financial stress relevant to the institution's portfolio. The choice of such historical data must be subject to at least annual review by the institution, which must notify the outcome to the GFSC.

Regulatory back testing and multiplication factors.

366.(1) The results of the calculations referred to in Article 365 must be scaled up by the multiplication factors (m c) and (m s).

(2) Each of the multiplication factors (m c) and (m s) must be the sum of at least 3 and an addend between 0 and 1 in accordance with Table 1. That addend must depend on the number of over-shootings for the most recent 250 business days as evidenced by the institution's back-testing of the value-at-risk number as set out in Article 365(1).

Table 1

Number of overshootings	addend
Fewer than 5	0,00
5	0,40
6	0,50
7	0,65
8	0,75
9	0,85
10 or more	1,00

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(3) The institutions must count daily over-shootings on the basis of back-testing on hypothetical and actual changes in the portfolio's value. An over-shooting is a one-day change in the portfolio's value that exceeds the related one-day value-at-risk number generated by the institution's model. For the purpose of determining the addend the number of over-shootings must be assessed at least quarterly and must be equal to the higher of the number of over-shootings under hypothetical and actual changes in the value of the portfolio.

Back-testing on hypothetical changes in the portfolio's value must be based on a comparison between the portfolio's end-of-day value and, assuming unchanged positions, its value at the end of the subsequent day.

Back-testing on actual changes in the portfolio's value must be based on a comparison between the portfolio's end-of-day value and its actual value at the end of the subsequent day excluding fees, commissions, and net interest income.

(4) The GFSC may in individual cases limit the addend to that resulting from over-shootings under hypothetical changes, where the number of over-shootings under actual changes does not result from deficiencies in the internal model.

(5) In order to allow the GFSC to monitor the appropriateness of the multiplication factors on an ongoing basis, institutions must notify promptly, and in any case no later than within five working days, the GFSC of over-shootings that result from their back-testing programme.

Requirements on risk measurement.

367.(1) Any internal model used to calculate capital requirements for position risk, foreign exchange risk, commodities risk and any internal model for correlation trading must meet all of the following requirements–

(a) the model must capture accurately all material price risks;

(b) the model must capture a sufficient number of risk factors, depending on the level of activity of the institution in the respective markets. Where a risk factor is incorporated into the institution's pricing model but not into the risk-measurement model, the institution must be able to justify such an omission to the satisfaction of the competent authority. The risk- measurement model must capture nonlinearities for options and other products as well as correlation risk and basis risk. Where proxies for risk factors are used they must show a good track record for the actual position held.

(2) Any internal model used to calculate capital requirements for position risk, foreign exchange risk or commodities risk must meet all of the following requirements–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) the model must incorporate a set of risk factors corresponding to the interest rates in each currency in which the institution has interest rate sensitive on- or off-balance sheet positions. The institution must model the yield curves using one of the generally accepted approaches. For material exposures to interest-rate risk in the major currencies and markets, the yield curve must be divided into a minimum of six maturity segments, to capture the variations of volatility of rates along the yield curve. The model must also capture the risk of less than perfectly correlated movements between different yield curves;

(b) the model must incorporate risk factors corresponding to gold and to the individual foreign currencies in which the institution's positions are denominated. For CIUs the actual foreign exchange positions of the CIU are taken into account. Institutions may rely on third party reporting of the foreign exchange position of the CIU, where the correctness of that report is adequately ensured. If an institution is not aware of the foreign exchange positions of a CIU, this position must be carved out and treated in accordance with Article 353(3);

(c) the model must use a separate risk factor at least for each of the equity markets in which the institution holds significant positions;

(d) the model must use a separate risk factor at least for each commodity in which the institution holds significant positions. The model must also capture the risk of less than perfectly correlated movements between similar, but not identical, commodities and the exposure to changes in forward prices arising from maturity mismatches. It must also take account of market characteristics, notably delivery dates and the scope provided to traders to close out positions;

(e) the institution's internal model must conservatively assess the risk arising from less liquid positions and positions with limited price transparency under realistic market scenarios. In addition, the internal model must meet minimum data standards. Proxies must be appropriately conservative and must be used only where available data is insufficient or is not reflective of the true volatility of a position or portfolio.

(3) Institutions may, in any internal model used for purposes of this Chapter, use empirical correlations within risk categories and across risk categories only if the institution's approach for measuring correlations is sound and implemented with integrity.

Qualitative requirements.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

368.(1) Any internal model used for purposes of this Chapter must be conceptually sound and implemented with integrity and, in particular, all of the following qualitative requirements must be met–

(a) any internal model used to calculate capital requirements for position risk, foreign exchange risk or commodities risk must be closely integrated into the daily risk-management process of the institution and serve as the basis for reporting risk exposures to senior management;

(b) the institution must have a risk control unit that is independent from business trading units and reports directly to senior management. The unit must be responsible for designing and implementing any internal model used for purposes of this Chapter. The unit must conduct the initial and on-going validation of any internal model used for purposes of this Chapter, being responsible for the overall risk management system. The unit must produce and analyse daily reports on the output of any internal model used for calculating capital requirements for position risk, foreign exchange risk and commodities risk, and on the appropriate measures to be taken in terms of trading limits;

(c) the institution's management body and senior management must be actively involved in the risk-control process and the daily reports produced by the risk-control unit are reviewed by a level of management with sufficient authority to enforce both reductions of positions taken by individual traders as well as in the institution's overall risk exposure;

(d) the institution must have sufficient numbers of staff skilled in the use of sophisticated internal models, and including those used for purposes of this Chapter, in the trading, risk-control, audit and back-office areas;

(e) the institution must have established procedures for monitoring and ensuring compliance with a documented set of internal policies and controls concerning the overall operation of its internal models, and including those used for purposes of this Chapter;

(f) any internal model used for purposes of this Chapter must have a proven track record of reasonable accuracy in measuring risks;

(g) the institution must frequently conduct a rigorous programme of stress testing, including reverse stress tests, which encompasses any internal model used for purposes of this Chapter and the results of these stress tests must be reviewed by senior management and reflected in the policies and limits it sets. This process must particularly address illiquidity of markets in stressed market conditions,

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

concentration risk, one way markets, event and jump-to-default risks, non-linearity of products, deep out-of-the-money positions, positions subject to the gapping of prices and other risks that may not be captured appropriately in the internal models. The shocks applied must reflect the nature of the portfolios and the time it could take to hedge out or manage risks under severe market conditions;

(h) the institution must conduct, as part of its regular internal auditing process, an independent review of its internal models, and including those used for purposes of this Chapter.

(2) The review referred to in paragraph (1)(h) must include both the activities of the business trading units and of the independent risk-control unit. At least once a year, the institution must conduct a review of its overall risk-management process. The review must consider the following–

(a) the adequacy of the documentation of the risk-management system and process and the organisation of the risk-control unit;

(b) the integration of risk measures into daily risk management and the integrity of the management information system;

(c) the process the institution employs for approving risk-pricing models and valuation systems that are used by front and back-office personnel;

(d) the scope of risks captured by the risk-measurement model and the validation of any significant changes in the risk-measurement process;

(e) the accuracy and completeness of position data, the accuracy and appropriateness of volatility and correlation assumptions, and the accuracy of valuation and risk sensitivity calculations;

(f) the verification process the institution employs to evaluate the consistency, timeliness and reliability of data sources used to run internal models, including the independence of such data sources;

(g) the verification process the institution uses to evaluate back-testing that is conducted to assess the models' accuracy.

(3) As techniques and best practices evolve, institutions must apply those new techniques and practices in any internal model used for purposes of this Chapter.

Internal Validation.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

369.(1) Institutions must have processes in place to ensure that all their internal models used for purposes of this Chapter have been adequately validated by suitably qualified parties independent of the development process to ensure that they are conceptually sound and adequately capture all material risks. The validation must be conducted when the internal model is initially developed and when any significant changes are made to the internal model. The validation must also be conducted on a periodic basis but especially where there have been any significant structural changes in the market or changes to the composition of the portfolio which might lead to the internal model no longer being adequate. As techniques and best practices for internal validation evolve, institutions must apply these advances. Internal model validation must not be limited to back-testing, but must, at a minimum, also include the following–

(a) tests to demonstrate that any assumptions made within the internal model are appropriate and do not underestimate or overestimate the risk;

(b) in addition to the regulatory back-testing programmes, institutions must carry out their own internal model validation tests, including back-testing, in relation to the risks and structures of their portfolios;

(c) the use of hypothetical portfolios to ensure that the internal model is able to account for particular structural features that may arise, for example material basis risks and concentration risk.

(2) The institution must perform back-testing on both actual and hypothetical changes in the portfolio's value.

Requirements particular to specific risk modelling

Requirements for modelling specific risk.

370. An internal model used for calculating own funds requirements for specific risk and an internal model for correlation trading must meet the following additional requirements–

(a) it explains the historical price variation in the portfolio;

(b) it captures concentration in terms of magnitude and changes of composition of the portfolio;

(c) it is robust to an adverse environment;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(d) it is validated through back-testing aimed at assessing whether specific risk is being accurately captured. If the institution performs such back-testing on the basis of relevant sub-portfolios, these must be chosen in a consistent manner;

(e) it captures name-related basis risk and must in particular be sensitive to material idiosyncratic differences between similar but not identical positions;

(f) it captures event risk.

Exclusions from specific risk models.

371.(1) An institution may choose to exclude from the calculation of its specific risk own funds requirement using an internal model those positions for which it fulfils an own funds requirement for specific risk in accordance with Article 332(1)(e) or Article 337 with exception of those positions that are subject to the approach set out in Article 377.

(2) An institution may choose not to capture default and migration risks for traded debt instruments in its internal model where it is capturing those risks through the requirements set out in Articles 372 to 376.

Internal model for incremental default and migration risk

Requirement to have an internal IRC model.

372. An institution that uses an internal model for calculating own funds requirements for specific risk of traded debt instruments must also have an internal incremental default and migration risk (IRC) model in place to capture the default and migration risks of its trading book positions that are incremental to the risks captured by the value-at-risk measure as specified in Article 365(1). The institution must demonstrate that its internal model meets the following standards under the assumption of a constant level of risk, and adjusted where appropriate to reflect the impact of liquidity, concentrations, hedging and optionality–

(a) the internal model provides a meaningful differentiation of risk and accurate and consistent estimates of incremental default and migration risk;

(b) the internal model's estimates for potential losses play an essential role in the risk management of the institution;

(c) the market and position data used for the internal model are up-to-date and subject to an appropriate quality assessment;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(d) the requirements in Article 367(3), Article 368, Article 369(1) and Article 370(b), (c), (e) and (f) are met.

Scope of the internal IRC model.

373. The internal IRC model must cover all positions subject to an own funds requirement for specific interest rate risk, including those subject to a 0% specific risk capital charge under Article 336, but must not cover securitisation positions and n-th-to-default credit derivatives.

The institution may, subject to GFSC approval, choose to consistently include all listed equity positions and derivatives positions based on listed equities. The GFSC must consider whether such inclusion is consistent with how the institution internally measures and manages risk.

Parameters of the internal IRC model.

374.(1) Institutions must use the internal model to calculate a number which measures losses due to default and internal or external ratings migration at the 99.9% confidence interval over a time horizon of one year. Institutions must calculate this number at least weekly.

(2) Correlation assumptions must be supported by analysis of objective data in a conceptually sound framework. The internal model must appropriately reflect issuer concentrations. Concentrations that can arise within and across product classes under stressed conditions must also be reflected.

(3) The internal IRC model must reflect the impact of correlations between default and migration events. The impact of diversification between, on the one hand, default and migration events and, on the other hand, other risk factors must not be reflected.

(4) The internal model must be based on the assumption of a constant level of risk over the one-year time horizon, implying that given individual trading book positions or sets of positions that have experienced default or migration over their liquidity horizon are re-balanced at the end of their liquidity horizon to attain the initial level of risk. Alternatively, an institution may choose to consistently use a one-year constant position assumption.

(5) The liquidity horizons must be set according to the time required to sell the position or to hedge all material relevant price risks in a stressed market, having particular regard to the size of the position. Liquidity horizons must reflect actual practice and experience during periods of both systematic and idiosyncratic stresses. The liquidity horizon must be measured under conservative assumptions and must be sufficiently long that the act of selling or hedging, in itself, would not materially affect the price at which the selling or hedging would be executed.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(6) The determination of the appropriate liquidity horizon for a position or set of positions is subject to a floor of three months.

(7) The determination of the appropriate liquidity horizon for a position or set of positions must take into account an institution's internal policies relating to valuation adjustments and the management of stale positions. When an institution determines liquidity horizons for sets of positions rather than for individual positions, the criteria for defining sets of positions must be defined in a way that meaningfully reflects differences in liquidity. The liquidity horizons must be greater for positions that are concentrated, reflecting the longer period needed to liquidate such positions. The liquidity horizon for a securitisation warehouse must reflect the time to build, sell and securitise the assets, or to hedge the material risk factors, under stressed market conditions.

Recognition of hedges in the internal IRC model.

375.(1) Hedges may be incorporated into an institution's internal model to capture the incremental default and migration risks. Positions may be netted when long and short positions refer to the same financial instrument. Hedging or diversification effects associated with long and short positions involving different instruments or different securities of the same obligor, as well as long and short positions in different issuers, may only be recognised by explicitly modelling gross long and short positions in the different instruments. Institutions must reflect the impact of material risks that could occur during the interval between the hedge's maturity and the liquidity horizon as well as the potential for significant basis risks in hedging strategies by product, seniority in the capital structure, internal or external rating, maturity, vintage and other differences in the instruments. An institution must reflect a hedge only to the extent that it can be maintained even as the obligor approaches a credit or other event.

(2) For positions that are hedged via dynamic hedging strategies, a rebalancing of the hedge within the liquidity horizon of the hedged position may be recognised if the institution–

(a) chooses to model rebalancing of the hedge consistently over the relevant set of trading book positions;

(b) demonstrates that the inclusion of rebalancing results in a better risk measurement;

(c) demonstrates that the markets for the instruments serving as hedges are liquid enough to allow for such rebalancing even during periods of stress. Any residual risks resulting from dynamic hedging strategies must be reflected in the own funds requirement.

Particular requirements for the internal IRC model.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

376.(1) The internal model to capture the incremental default and migration risks must reflect the nonlinear impact of options, structured credit derivatives and other positions with material nonlinear behaviour with respect to price changes. The institution must also have due regard to the amount of model risk inherent in the valuation and estimation of price risks associated with such products.

(2) The internal model must be based on data that are objective and up-to-date.

(3) As part of the independent review and validation of their internal models used for purposes of this Chapter, inclusively for purposes of the risk measurement system, an institution must in particular do all of the following–

(a) validate that its modelling approach for correlations and price changes is appropriate for its portfolio, including the choice and weights of its systematic risk factors;

(b) perform a variety of stress tests, including sensitivity analysis and scenario analysis, to assess the qualitative and quantitative reasonableness of the internal model, particularly with regard to the treatment of concentrations. Such tests must not be limited to the range of events experienced historically;

(c) apply appropriate quantitative validation including relevant internal modelling benchmarks.

(4) The internal model must be consistent with the institution's internal risk management methodologies for identifying, measuring, and managing trading risks.

(5) Institutions must document their internal models so that its correlation and other modelling assumptions are transparent to the GFSC.

(6) The internal model must conservatively assess the risk arising from less liquid positions and positions with limited price transparency under realistic market scenarios. In addition, the internal model must meet minimum data standards. Proxies must be appropriately conservative and may be used only where available data is insufficient or is not reflective of the true volatility of a position or portfolio.

Internal model for correlation trading

Requirements for an internal model for correlation trading.

377.(1) The GFSC, when considering an application to grant approval to use an internal model for the own funds requirement for the correlation trading portfolio instead of the own funds

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

requirement in accordance with Article 338 to institutions that are allowed to use an internal model for specific risk of debt instruments, must take into account whether the requirements in paragraphs (2) to (6) and in Article 367(1) and (3), Article 368, Article 369(1) and Article 370(a), (b), (c), (e) and (f) are met.

(2) Institutions must use this internal model to calculate a number which adequately measures all price risks at the 99.9% confidence interval over a time horizon of one year under the assumption of a constant level of risk, and adjusted where appropriate to reflect the impact of liquidity, concentrations, hedging and optionality. Institutions must calculate this number at least weekly.

(3) The following risks must be adequately captured by the model referred to in paragraph (1)–

(a) the cumulative risk arising from multiple defaults, including different ordering of defaults, in tranched products;

(b) credit spread risk, including the gamma and cross-gamma effects;

(c) volatility of implied correlations, including the cross effect between spreads and correlations;

(d) basis risk, including both of the following–

(i) the basis between the spread of an index and those of its constituent single names;

(ii) the basis between the implied correlation of an index and that of bespoke portfolios;

(e) recovery rate volatility, as it relates to the propensity for recovery rates to affect tranche prices;

(f) to the extent the comprehensive risk measure incorporates benefits from dynamic hedging, the risk of hedge slippage and the potential costs of rebalancing such hedges;

(g) any other material price risks of positions in the correlation trading portfolio.

(4) An institution must use sufficient market data within the model referred to in paragraph (1) in order to ensure that it fully captures the salient risks of those exposures in its internal approach in accordance with the requirements set out in this Article. It must be able to

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

demonstrate to the GFSC through back testing or other appropriate means that its model can appropriately explain the historical price variation of those products.

The institution must have appropriate policies and procedures in place in order to separate the positions for which it holds approval to incorporate them in the own funds requirement in accordance with this Article from other positions for which it does not hold such approval.

(5) With regard to the portfolio of all the positions incorporated in the model referred to in paragraph (1), the institution must regularly apply a set of specific, predetermined stress scenarios. Such stress scenarios must examine the effects of stress to default rates, recovery rates, credit spreads, basis risk, correlations and other relevant risk factors on the correlation trading portfolio. The institution must apply stress scenarios at least weekly and report at least quarterly to the GFSC the results, including comparisons with the institution's own funds requirement in accordance with this Article. Any instances where the stress test results materially exceed the own funds requirement for the correlation trading portfolio must be reported to the GFSC in a timely manner.

(6) The internal model must conservatively assess the risk arising from less liquid positions and positions with limited price transparency under realistic market scenarios. In addition, the internal model must meet minimum data standards. Proxies must be appropriately conservative and may be used only where available data is insufficient or is not reflective of the true volatility of a position or portfolio.

TITLE 5
OWN FUNDS REQUIREMENTS FOR SETTLEMENT RISK

Settlement/delivery risk.

378. In the case of transactions in which debt instruments, equities, foreign currencies and commodities excluding repurchase transactions and securities or commodities lending and securities or commodities borrowing are unsettled after their due delivery dates, an institution must calculate the price difference to which it is exposed.

The price difference is calculated as the difference between the agreed settlement price for the debt instrument, equity, foreign currency or commodity in question and its current market value, where the difference could involve a loss for the credit institution.

The institution must multiply that price difference by the appropriate factor in the right column of the following Table 1 in order to calculate the institution's own funds requirement for settlement risk.

Table 1

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Number of working days after due settlement date	(%)
5 — 15	8
16 — 30	50
31 — 45	75
46 or more	100

Free deliveries.

379.(1) An institution must hold own funds, as set out in Table 2, where the following occurs–

(a) it has paid for securities, foreign currencies or commodities before receiving them or it has delivered securities, foreign currencies or commodities before receiving payment for them;

(b) in the case of cross-border transactions, one day or more has elapsed since it made that payment or delivery.

Table 2

Capital treatment for free deliveries

Column 1	Column 2	Column 3	Column 4
Transaction Type	Up to first contractual payment or delivery leg	From first contractual payment or delivery leg up to four days after second contractual payment or delivery leg	From 5 business days post second contractual payment or delivery leg until extinction of the transaction
Free delivery	No capital charge	Treat as an exposure	Treat as an exposure risk weighted at 1 250 %

(2) In applying a risk weight to free delivery exposures treated according to Column 3 of Table 2, an institution using the Internal Ratings Based approach set out in Part 3, Title 2, Chapter 3 may assign PDs to counterparties, for which it has no other non-trading book exposure, on the basis of the counterparty's external rating. Institutions using own estimates of ‘LGDs’ may apply the LGD set out in Article 161(1) to free delivery exposures treated according to Column 3 of Table 2 if they apply it to all such exposures. Alternatively, an institution using the Internal Ratings Based approach set out in Part 3, Title 2, Chapter 3 may apply the risk weights of the Standardised Approach, as set out in Part 3, Title 2, Chapter 2 if it applies them to all such exposures or may apply a 100% risk weight to all such exposures.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

If the amount of positive exposure resulting from free delivery transactions is not material, institutions may apply a risk weight of 100% to these exposures, except where a risk weight of 1,250% in accordance with Column 4 of Table 2 in paragraph (1) is required.

(3) As an alternative to applying a risk weight of 1,250% to free delivery exposures according to Column 4 of Table 2 in paragraph (1), institutions may deduct the value transferred plus the current positive exposure of those exposures from Common Equity Tier 1 items in accordance with Article 36(1)(k).

Waiver.

380. Where a system wide failure of a settlement system, a clearing system or a CCP occurs, the GFSC may waive the own funds requirements calculated as set out in Articles 378 and 379 until the situation is rectified. In this case, the failure of a counterparty to settle a trade must not be deemed a default for purposes of credit risk.

TITLE 6
OWN FUNDS REQUIREMENTS FOR CREDIT VALUATION ADJUSTMENT RISK

Meaning of credit valuation adjustment.

381. For the purposes of this Title and Chapter 6 of Title 2, “credit valuation adjustment” or “CVA” means an adjustment to the mid-market valuation of the portfolio of transactions with a counterparty. That adjustment reflects the current market value of the credit risk of the counterparty to the institution, but does not reflect the current market value of the credit risk of the institution to the counterparty.

Scope.

382.(1) An institution must calculate the own funds requirements for CVA risk in accordance with this Title for all OTC derivative instruments in respect of all of its business activities, other than credit derivatives recognised to reduce risk-weighted exposure amounts for credit risk.

(2) An institution must include securities financing transactions in the calculation of own funds required by paragraph (1) if the GFSC determines that the institution's CVA risk exposures arising from those transactions are material.

(3) Transactions with a qualifying central counterparty and a client's transactions with a clearing member, when the clearing member is acting as an intermediary between the client and a qualifying central counterparty and the transactions give rise to a trade exposure of the

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

clearing member to the qualifying central counterparty, are excluded from the own funds requirements for CVA risk.

(4) The following transactions are excluded from the own funds requirements for CVA risk–

(a) transactions with non-financial counterparties as defined in Article 2(9) of EMIR, or with non-financial counterparties established in a third country, where those transactions do not exceed the clearing threshold as specified in Article 10(3) and (4) of that Regulation;

(b) intragroup transactions as provided for in Article 3 of EMIR unless the GFSC requires intragroup transactions between structurally separated entities to be included in the own funds requirements;

(c) transactions with counterparties referred to in Article 2(10) of EMIR and subject to the transitional provisions set out in Article 89(1) of that Regulation until those transitional provisions cease to apply;

(d) transactions with counterparties referred to in Article 1(4) and (5) of Regulation (EU) No 648/2012 and transactions with counterparties for which Article 114(4) and Article 115(2) specifies a risk weight of 0% for exposures to those counterparties.

The exemption from the CVA risk charge for those transactions referred to in sub-paragraph (c) which are entered into during the transitional period laid down in Article 89(1) of EMIR must apply for the length of the contract of that transaction.

In regard to sub-paragraph (a), where an institution ceases to be exempt through crossing the exemption threshold or due to a change in the exemption threshold, outstanding contracts must remain exempt until the date of their maturity.

(5) [Not used]

Advanced method.

383.(1) An institution which has approval to use an internal model for the specific risk of debt instruments in accordance with Article 363(1)(d) must, for all transactions for which it has approval to use the IMM for determining the exposure value for the associated counterparty credit risk exposure in accordance with Article 283, determine the own funds requirements for CVA risk by modelling the impact of changes in the counterparties' credit spreads on the CVAs of all counterparties of those transactions, taking into account CVA hedges that are eligible in accordance with Article 386.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

An institution must use its internal model for determining the own funds requirements for the specific risk associated with traded debt positions and must apply a 99% confidence interval and a 10-day equivalent holding period. The internal model must be used in such way that it simulates changes in the credit spreads of counterparties, but does not model the sensitivity of CVA to changes in other market factors, including changes in the value of the reference asset, commodity, currency or interest rate of a derivative.

The own funds requirements for CVA risk for each counterparty must be calculated in accordance with the following formula–

$$CVA = LGD_{MKT} \times \sum_{i=1}^{T} \max\left\{0, \exp\left(-\frac{s_{i-1} \times t_{i-1}}{LGD_{MKT}}\right) - \exp\left(-\frac{s_i \times t_i}{LGD_{MKT}}\right)\right\} \times \frac{EE_{i-1} \times D_{i-1} + EE_i \times D_i}{2}$$

where–

t_i = the time of the i-th revaluation, starting from $t_0 = 0$;

t_T = the longest contractual maturity across the netting sets with the counterparty;

s_i = is the credit spread of the counterparty at tenor ti, used to calculate the CVA of the counterparty. Where the credit default swap spread of the counterparty is available, an institution must use that spread. Where such a credit default swap spread is not available, an institution must use a proxy spread that is appropriate having regard to the rating, industry and region of the counterparty;

LGD_{MKT} = the LGD of the counterparty is based on the spread of a market instrument of the counterparty if a counterparty instrument is available. Where a counterparty instrument is not available, it must be based on the proxy spread that is appropriate having regard to the rating, industry and region of the counterparty.

The first factor within the sum represents an approximation of the market implied marginal probability of a default occurring between times t_{i-1} and t_i;

EE_i = the expected exposure to the counterparty at revaluation time ti, where exposures of different netting sets for such counterparty are added, and where the longest maturity of each netting set is given by the longest contractual maturity inside the netting set; An institution must apply the treatment set out in paragraph (3) in the case of margined trading, if the institution uses the EPE measure referred to in Article 285(1)(a) or (b) for margined trades;

D_i = the default risk-free discount factor at time ti, where $D_0 = 1$.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(2) When calculating the own funds requirements for CVA risk for a counterparty, an institution must base all inputs into its internal model for specific risk of debt instruments on the following formulae (whichever is appropriate)–

(a) where the model is based on full repricing, the formula in paragraph (1) must be used directly;

(b) where the model is based on credit spread sensitivities for specific tenors, an institution must base each credit spread sensitivity ('Regulatory CS01') on the following formula–

$$\text{Regulatory CS01}_i = 0.0001 \times t_i \times \exp\left(-\frac{s_i \times t_i}{\text{LGD}_{\text{MKT}}}\right) \times \frac{\text{EE}_{i-1} \times D_{i-1} - \text{EE}_{i+1} \times D_{i+1}}{2}$$

For the final time bucket i=T, the corresponding formula is–

$$\text{Regulatory CS01}_T = 0.0001 \times t_T \times \exp\left(-\frac{s_T \times t_T}{\text{LGD}_{\text{MKT}}}\right) \times \frac{\text{EE}_{T-1} \times D_{T-1} + \text{EE}_T \times D_T}{2}$$

(c) where the model uses credit spread sensitivities to parallel shifts in credit spreads, an institution must use the following formula–

$$\text{Regulatory CS01} = 0.0001 \times \sum_{i=1}^{T} \left(t_i \times \exp\left(-\frac{s_i \times t_i}{\text{LGD}_{\text{MKT}}}\right) - t_{i-1} \times \exp\left(-\frac{s_{i-1} \times t_{i-1}}{\text{LGD}_{\text{MKT}}}\right)\right) \times \frac{\text{EE}_{i-1} \times D_{i-1} + \text{EE}_i \times D_i}{2}$$

(d) where the model uses second-order sensitivities to shifts in credit spreads (spread gamma), the gammas must be calculated based on the formula in paragraph (1).

(3) An institution using the EPE measure for collateralised OTC derivatives referred to of Article 285(1)(a) or (b) must, when determining the own funds requirements for CVA risk in accordance with paragraph (1), do both of the following–

(a) assume a constant EE profile;

(b) set EE equal to the effective expected exposure as calculated under Article 285(1)(b) for a maturity equal to the greater of the following–

(i) half of the longest maturity occurring in the netting set;

(ii) the notional weighted average maturity of all transactions inside the netting set.

(4) An institution which is permitted by the GFSC in accordance with Article 283 to use IMM to calculate exposure values in relation to the majority of its business, but which uses the

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

methods set out in Articles 274 to 282 6 for smaller portfolios, and which has approval to use the market risk internal model for the specific risk of debt instruments in accordance with Article 363(1)(d) may, subject to GFSC approval, calculate the own funds requirements for CVA risk in accordance with paragraph (1) for the non-IMM netting sets. The GFSC must consider whether the institution uses the methods set out in Articles 274 to 282 for a limited number of smaller portfolios.

For the purposes of a calculation under the preceding sub-paragraph and where the IMM model does not produce an expected exposure profile, an institution must do both of the following–

(a) assume a constant EE profile;

(b) set EE equal to the exposure value as computed under the methods set out in Articles 274 to 282, or IMM for a maturity equal to the greater of–

(i) half of the longest maturity occurring in the netting set;

(ii) the notional weighted average maturity of all transactions inside the netting set.

(5) An institution must determine the own funds requirements for CVA risk in accordance with Article 364(1) and Articles 365 and 367 as the sum of non-stressed and stressed value-at-risk, which must be calculated as follows–

(a) for the non-stressed value-at-risk, current parameter calibrations for expected exposure as set out in the first sub-paragraph of Article 292(2), must be used;

(b) for the stressed value-at-risk, future counterparty EE profiles using a stressed calibration as set out in the second sub-paragraph of Article 292(2) must be used. The period of stress for the credit spread parameters must be the most severe one-year stress period contained within the three-year stress period used for the exposure parameters;

(c) the three-times multiplication factor used in the calculation of own funds requirements based on a value-at-risk and a stressed value-at-risk in accordance with 364(1) will apply to these calculations.

(d) the calculation must be carried out on at least a monthly basis and the EE that is used must be calculated on the same frequency. If lower than a daily frequency is used, for the purpose of the calculation specified in Article 364(1)(a)(ii) and (b)(ii) institutions must take the average over three months.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(6) For exposures to a counterparty, for which the institution's approved internal model for the specific risk of debt instruments does not produce a proxy spread that is appropriate with respect to the criteria of rating, industry and region of the counterparty, the institution must use the method set out in Article 384 to calculate the own funds requirement for CVA risk.

(7) [Not used]

Standardised method.

384.(1) An institution which does not calculate the own funds requirements for CVA risk for its counterparties in accordance with Article 383 must calculate a portfolio own funds requirements for CVA risk for each counterparty in accordance with the following formula, taking into account CVA hedges that are eligible in accordance with Article 386–

$$K = 2.33 \times \sqrt{h} \times \sqrt{\left(\sum_i 0.5 \times w_i \times \left(M_i \times \mathrm{EAD}^i_{\mathrm{total}} - M^i_{\mathrm{hedge}} B_i\right) - \sum_{\mathrm{ind}} w_{\mathrm{ind}} \times M_{\mathrm{ind}} \times B_{\mathrm{ind}}\right)^2 + \sum_i 0.75 \times w_2^i \times \left(M_i \times \mathrm{EAD}^i_{\mathrm{total}} - M^i_{\mathrm{hedge}} B_i\right)^2}$$

where–

h = the one-year risk horizon (in units of a year); h = 1;

w_i = the weight applicable to counterparty ‘ i ’ .

Counterparty ‘ i ’ must be mapped to one of the six weights wi based on an external credit assessment by a nominated ECAI, as set out in Table 1. For a counterparty for which a credit assessment by a nominated ECAI is not available–

(a) an institution using the approach in Title 2, Chapter 3 must map the internal rating of the counterparty to one of the external credit assessment;

(b) an institution using the approach in Title 2, Chapter 2 must assign wi=1.0% to this counterparty. However, if an institution uses Article 128 to risk weight counterparty credit risk exposures to this counterparty, wi=30% must be assigned;

EAD_i^{total} = the total counterparty credit risk exposure value of counterparty “i” (summed across its netting sets) including the effect of collateral in accordance with the methods set out in Articles 274 to 294 as applicable to the calculation of the own funds requirements for counterparty credit risk for that counterparty.

For an institution not using the method set out in Articles 283 to 294, the exposure must be discounted by applying the following factor–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

$\frac{1-e^{-0.05\times M_i}}{0.05\times M_i}$

B_i = the notional of purchased single name credit default swap hedges (summed if more than one position) referencing counterparty ‘ i ’ and used to hedge CVA risk.

That notional amount must be discounted by applying the following factor–

$\frac{1-e^{-0.05\times M^i_{hedge}}}{0.05\times M^i_{hedge}}$

B_{ind} = is the full notional of one or more index credit default swap of purchased protection used to hedge CVA risk.

That notional amount must be discounted by applying the following factor–

$\frac{1-e^{-0.05\times M_{ind}}}{0.05\times M_{ind}}$

w_{ind} = is the weight applicable to index hedges.

An institution must determine w_{ind} by calculating a weighted average of wi that are applicable to the individual constituents of the index;

M_i = the effective maturity of the transactions with counterparty i.

For an institution using the method set out in Articles 283 to 294, M_i is calculated in accordance with Article 162(2)(g). However, for that purpose, M_i must not be capped at five years but at the longest contractual remaining maturity in the netting set.

For an institution not using the method set out in Articles 283 to 294, M_i is the average notional weighted maturity as referred to in Article 162(2)(b). However, for that purpose, M_i must not be capped at five years but at the longest contractual remaining maturity in the netting set.

M^i_{hedge} = the maturity of the hedge instrument with notional B_i (the quantities

M^i_{hedge}

B_i are to be summed if these are several positions);

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

M_{ind} = the maturity of the index hedge.

In the case of more than one index hedge position, M_{ind} is the notional-weighted maturity.

(2) Where a counterparty is included in an index on which a credit default swap used for hedging counterparty credit risk is based, the institution may subtract the notional amount attributable to that counterparty in accordance with its reference entity weight from the index CDS notional amount and treat it as a single name hedge (B_i) of the individual counterparty with maturity based on the maturity of the index.

Table 1

Credit quality step	Weight w_i
1	0,7 %
2	0,8 %
3	1,0 %
4	2,0 %
5	3,0 %
6	10,0 %

Alternative to using CVA methods in calculating own funds requirements.

385. As an alternative to Article 384, for instruments referred to in Article 382 and subject to the prior consent of the GFSC, institutions using the Original Exposure Method as laid down in Article 282 may apply a multiplication factor of 10 to the resulting risk-weighted exposure amounts for counterparty credit risk for those exposures instead of calculating the own funds requirements for CVA risk.

Eligible hedges.

386.(1) Hedges must be "eligible hedges" for the purposes of the calculation of own funds requirements for CVA risk in accordance with Articles 383 and 384 only where they are used for the purpose of mitigating CVA risk and managed as such, and are one of the following–

(a) single-name credit default swaps or other equivalent hedging instruments referencing the counterparty directly;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(b) index credit default swaps, if the basis between any individual counterparty spread and the spreads of index credit default swap hedges is reflected, to the satisfaction of the competent authority, in the value-at-risk and the stressed value-at-risk.

The requirement in sub-paragraph (b) that the basis between any individual counterparty spread and the spreads of index credit default swap hedges is reflected in the value-at-risk and the stressed value-at-risk must also apply to cases where a proxy is used for the spread of a counterparty.

For all counterparties for which a proxy is used, an institution must use reasonable basis time series out of a representative group of similar names for which a spread is available.

If the basis between any individual counterparty spread and the spreads of index credit default swap hedges is not reflected to the satisfaction of the competent authority, then an institution must reflect only 50% of the notional amount of index hedges in the value-at-risk and the stressed value-at-risk.

Over-hedging of the exposures with single name credit default swaps under the method laid out in Article 383 is not allowed.

(2) An institution must not reflect other types of counterparty risk hedges in the calculation of the own funds requirements for CVA risk. In particular, tranched or nth-to-default credit default swaps and credit linked notes are not eligible hedges for the purposes the calculation of the own funds requirements for CVA risk.

(3) Eligible hedges that are included in the calculation of the own funds requirements for CVA risk must not be included in the calculation of the own funds requirements for specific risk as set out in Title 4 or treated as credit risk mitigation other than for the counterparty credit risk of the same portfolio of transaction.

PART 4
LARGE EXPOSURES

Subject matter.

387. Institutions must monitor and control their large exposures in accordance with this Part.

388. [Not used]

Definition.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

389. For the purposes of this Part, “exposures”, means any asset or off-balance sheet item referred to in Part 3, Title 2, Chapter 2, without applying the risk weights or degrees of risk.

Calculation of the exposure value.

390.(1) The total exposures to a group of connected clients must be calculated by adding together the exposures to individual clients in that group.

(2) The overall exposures to individual clients must be calculated by adding the exposures to the relevant individual client in the trading book and the exposures to the relevant individual client in the non-trading book.

(3) For exposures in the trading book, an institution may–

(a) offset its long positions and short positions in the same financial instruments issued by a given client, with the net position in each of the different instruments being calculated in accordance with the methods laid down in Part 3, Title 4, Chapter 2;

(b) offset its long positions and short positions in different financial instruments issued by a given client, but only where the financial instrument underlying the short position is junior to the financial instrument underlying the long position or where the underlying instruments are of the same seniority.

For the purposes of sub-paragraphs (a) and (b), financial instruments may be allocated into buckets on the basis of different degrees of seniority in order to determine the relative seniority of positions.

(4) Institutions must calculate the exposure values of the derivative contracts listed in Schedule 2 and of credit derivative contracts directly entered into with a client in accordance with one of the methods set out in Articles 274 to 282 , as applicable. Exposures resulting from the transactions referred to in Articles 378, 379 and 380 must be calculated in the manner laid down in those Articles.

When calculating the exposure value for the contracts referred to in the first sub-paragraph, where those contracts are allocated to the trading book, institutions must also comply with the principles set out in Article 299.

By way of derogation from the first sub-paragraph, institutions with approval to use the methods referred to in Articles 218 to 236 and 283 to 294 may use those methods for calculating the exposure value for securities financing transactions.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(5) Institutions must add to the total exposure to a client the exposures arising from derivative contracts listed in Schedule 2 and credit derivative contracts, where the contract was not directly entered into with that client but the underlying debt or equity instrument was issued by that client.

(6) The term "exposures" does not include any of the following–

(a) in the case of foreign exchange transactions, exposures incurred in the ordinary course of settlement during the two business days following payment;

(b) in the case of transactions for the purchase or sale of securities, exposures incurred in the ordinary course of settlement during the five business days following payment or delivery of the securities, whichever is the earlier;

(c) in the case of the provision of money transmission including the execution of payment services, clearing and settlement in any currency and correspondent banking or financial instruments clearing, settlement and custody services to clients, delayed receipts in funding and other exposures arising from client activity which do not last longer than the following business day;

(d) in the case of the provision of money transmission including the execution of payment services, clearing and settlement in any currency and correspondent banking, intra-day exposures to institutions providing those services; and

(e) exposures deducted from Common Equity Tier 1 items or Additional Tier 1 items in accordance with Articles 36 and 56 or any other deduction from those items that reduces the solvency ratio.

(7) To determine the overall exposure to a client or a group of connected clients, in respect of clients to which the institution has exposures through transactions referred to in Article 112(m) and (o) or through other transactions where there is an exposure to underlying assets, an institution must assess its underlying exposures taking into account the economic substance of the structure of the transaction and the risks inherent in the structure of the transaction itself, in order to determine whether it constitutes an additional exposure.

(8) [Not used]

Definition of an institution for large exposures purposes.

391. For the purposes of calculating the value of exposures in accordance with this Part the term 'institution' must include a private or public undertaking, including its branches, which, were it established in Gibraltar, would fulfil the definition of the term 'institution' and has

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

been authorised in a third country that applies prudential supervisory and regulatory requirements at least equivalent to those applied in Gibraltar.

For the purposes of this Article, the Minister may determine that a third country applies prudential supervisory and regulatory requirements at least equivalent to those applied in Gibraltar.

Definition of a large exposure.

392. An institution's exposure to a client or a group of connected clients must beconsidered a large exposure where the value of the exposure is equal to or exceeds 10% of its Tier 1 capital.

Capacity to identify and manage large exposures.

393. An institution must have sound administrative and accounting procedures and adequate internal control mechanisms for the purposes of identifying, managing, monitoring, reporting and recording all large exposures and subsequent changes to them, in accordance with these Standards.

Reporting requirements.

394.(1) Institutions must report the following information to the GFSC for each large exposure that they hold, including large exposures exempted from the application of Article 395(1)–

(a) the identity of the client or the group of connected clients to which the institution has a large exposure;

(b) the exposure value before taking into account the effect of the credit risk mitigation, where applicable;

(c) where used, the type of funded or unfunded credit protection; and

(d) the exposure value, after taking into account the effect of the credit risk mitigation calculated for the purposes of Article 395(1), where applicable.

Institutions that are subject to Chapter 3 of Title 2 of Part 3 must report their 20 largest exposures to the GFSC on a consolidated basis, excluding the exposures exempted from the application of Article 395(1).

Institutions must also report exposures of a value greater than or equal to £260 million but less than 10% of the institution's Tier 1 capital to the GFSC on a consolidated basis.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(2) In addition to the information referred to in paragraph (1), institutions must report the following information to the GFSC in relation to their 10 largest exposures to institutions on a consolidated basis, as well as their 10 largest exposures to shadow banking entities which carry out banking activities outside the regulated framework on a consolidated basis, including large exposures exempted from the application of Article 395(1)–

(a) the identity of the client or the group of connected clients to which an institution has a large exposure;

(b) the exposure value before taking into account the effect of the credit risk mitigation, where applicable;

(c) where used, the type of funded or unfunded credit protection;

(d) the exposure value after taking into account the effect of the credit risk mitigation calculated for the purposes of Article 395(1), where applicable.

(3) Institutions must report the information referred to in paragraphs (1) and (2) to the GFSC on at least a semi-annual basis.

(4) to (5) [Not used]

Limits to large exposures.

395.(1) An institution must not incur an exposure to a client or group of connected clients the value of which exceeds 25% of its Tier 1 capital, after taking into account the effect of the credit risk mitigation in accordance with Articles 399 to 403. Where that client is an institution or an investment firm, or where a group of connected clients includes one or more institutions or investment firms, that value must not exceed 25% of the institution's Tier 1 capital or £130 million, whichever is higher, if the sum of exposure values, after taking into account the effect of the credit risk mitigation in accordance with Articles 399 to 403, to all connected clients that are not institutions or investment firms, does not exceed 25% of the institution's Tier 1 capital.

Where the amount of £130 million is higher than 25% of the institution's eligible capital, the value of the exposure, after taking into account the effect of credit risk mitigation in accordance with Articles 399 to 403, must not exceed a reasonable limit in terms of the institution's Tier 1 capital. That limit is determined by the institution in accordance with the policies and procedures referred to in regulation 38 of the CICR Regulations, to address and control concentration risk. That limit must not exceed 100% of the institution's Tier 1 capital.

(2) [Not used]

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(3) Subject to Article 396, an institution must at all times comply with the relevant limit laid down in paragraph (1).

(4) Assets constituting claims and other exposures onto recognised third-country investment firms may be subject to the same treatment as set out in paragraph (1).

(5) The limits laid down in this Article may be exceeded for the exposures in the institution's trading book, if all the following conditions are met–

(a) the exposure in the non-trading book to the client or group of connected clients in question does not exceed the limit laid down in paragraph (1), this limit being calculated with reference to Tier 1 capital, so that the excess arises entirely in the trading book;

(b) the institution meets an additional own funds requirement on the part of the exposure in excess of the limit laid down in paragraph (1) which is calculated in accordance with Articles 397 and 398;

(c) where 10 days or less have elapsed since the excess referred to in sub-paragraph (b) occurred, the trading-book exposure to the client or group of connected clients in question does not exceed 500% of the institution's Tier 1 capital;

(d) any excesses that have persisted for more than 10 days do not, in aggregate, exceed 600% of the institution's Tier 1 capital.

Each time the limit has been exceeded, the institution must report to the GFSC without delay the amount of the excess and the name of the client concerned and, where applicable, the name of the group of connected clients concerned.

Compliance with large exposures requirements.

396.(1) If, in an exceptional case, exposures exceed the limit set out in Article 395(1), the institution must report the value of the exposure without delay to the GFSC which may, where the circumstances warrant it, allow the institution a limited period of time in which to comply with the limit.

Where the amount of £130 million referred to in Article 395(1) is applicable, the GFSC may allow the 100% limit in terms of the institution's Tier 1 capital to be exceeded on a case-by-case basis.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Where, in the exceptional cases referred to in the first and second sub-paragraph, a the GFSC allows an institution to exceed the limit set out in Article 395(1) for a period longer than three months, the institution must present a plan for a timely return to compliance with that limit to the satisfaction of the GFSC and must carry out that plan within the period agreed with the GFSC.

(2) Where compliance by an institution on an individual or sub- consolidated basis with the obligations imposed in this Part is waived under Article 7(1), or the provisions of Article 9 are applied in the case of Gibraltar parent institutions, measures must be taken to ensure the satisfactory allocation of risks within the group.

Calculating additional own funds requirements for large exposures in the trading book.

397.(1) The excess referred to in Article 395(5)(b) must be calculated by selecting those components of the total trading exposure to the client or group of connected clients in question which attract the highest specific-risk requirements in Part 3, Title 4, Chapter 2 and/or requirements in Article 299 and Part 3, Title 5, the sum of which equals the amount of the excess referred to in Article 395(5)(a).

(2) Where the excess has not persisted for more than 10 days, the additional capital requirement must be 200% of the requirements referred to in paragraph (1), on these components.

(3) As from 10 days after the excess has occurred, the components of the excess, selected in accordance with paragraph (1), are allocated to the appropriate line in Column 1 of Table 1 in ascending order of specific-risk requirements in Part 3, Title 4, Chapter 2 and/or requirements in Article 299 and Part 3, Title 5. The additional own funds requirement must be equal to the sum of the specific-risk requirements in Part 3, Title 4, Chapter 2 and/or the Article 299 and Part 3, Title 5 requirements on these components, multiplied by the corresponding factor in Column 2 of Table 1.

Table 1

Column 1: Excess over the limits (on the basis of a percentage of Tier 1 capital)	Column 2: Factors
Up to 40 %	200 %
From 40 % to 60 %	300 %
From 60 % to 80 %	400 %
From 80 % to 100 %	500 %
From 100 % to 250 %	600 %
Over 250 %	900 %

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Procedures to prevent institutions from avoiding the additional own funds requirement.

398. Institutions must not deliberately avoid the additional own funds requirements set out in Article 397 that they would otherwise incur, on exposures exceeding the limit laid down in Article 395(1) once those exposures have been maintained for more than 10 days, by means of temporarily transferring the exposures in question to another company, whether within the same group or not, and/or by undertaking artificial transactions to close out the exposure during the 10-day period and create a new exposure.

Institutions must maintain systems which ensure that any transfer which has the effect referred to in the first sub-paragraph is immediately reported to the GFSC.

Eligible credit mitigation techniques.

399.(1) An institution must use a credit risk mitigation technique in the calculation of an exposure where it has used that technique to calculate capital requirements for credit risk in accordance with Title 2 of Part 3, if the credit risk mitigation technique meets the conditions set out in this Article.

For the purposes of Articles 400 to 403, the term “guarantee” includes credit derivatives recognised under Chapter 4 of Title 2 of Part 3 other than credit linked notes.

(2) Subject to paragraph (3), the recognition of funded or unfunded credit protection in accordance with Articles 400 to 403 is only permitted if the eligibility requirements and other requirements set out in Part 3, Title 2, Chapter 4.

(3) Credit risk mitigation techniques which are available if an institution is permitted to use one of the IRB approaches must not be used to reduce exposure values for large exposure purposes.

(4) Institutions must analyse, to the extent possible, their exposures to collateral issuers, providers of unfunded credit protection and underlying assets pursuant to Article 390(7) for possible concentrations and where appropriate take action and report any significant findings to the GFSC.

Exemptions.

400.(1) The following exposures must be exempted from the application of Article 395(1)–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) asset items constituting claims on central governments, central banks or public sector entities which, unsecured, would be assigned a 0% risk weight under Part 3, Title 2, Chapter 2;

(b) asset items constituting claims on international organisations or multilateral development banks which, unsecured, would be assigned a 0% risk weight under Part 3, Title 2, Chapter 2;

(c) asset items constituting claims carrying the explicit guarantees of central governments, central banks, international organisations, multilateral development banks or public sector entities, where unsecured claims on the entity providing the guarantee would be assigned a 0% risk weight under Part 3, Title 2, Chapter 2;

(d) other exposures attributable to, or guaranteed by, central governments, central banks, international organisations, multilateral development banks or public sector entities, where unsecured claims on the entity to which the exposure is attributable or by which it is guaranteed would be assigned a 0% risk weight under Part 3, Title 2, Chapter 2;

(e) asset items constituting claims on regional governments or local authorities where those claims would be assigned a 0% risk weight under Part 3, Title 2, Chapter 2 and other exposures to or guaranteed by those regional governments or local authorities, claims on which would be assigned a 0% risk weight under Part 3, Title 2, Chapter 2;

(f) exposures to counterparties referred to in Article 113(6) or (7) if they would be assigned a 0% risk weight under Part 3, Title 2, Chapter 2. Exposures that do not meet those criteria, whether or not exempted from Article 395(1) are treated as exposures to a third party;

(g) asset items and other exposures secured by collateral in the form of cash deposits placed with the lending institution or with an institution which is the parent undertaking or a subsidiary of the lending institution;

(h) asset items and other exposures secured by collateral in the form of certificates of deposit issued by the lending institution or by an institution which is the parent undertaking or a subsidiary of the lending institution and lodged with either of them;

(i) exposures arising from undrawn credit facilities that are classified as low-risk off-balance sheet items in Schedule 1 and if an agreement has been concluded with the client or group of connected clients under which the facility may be drawn only

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

if it has been ascertained that it will not cause the limit applicable under Article 395(1) to be exceeded;

(j) clearing members' trade exposures and default fund contributions to qualified central counterparties; and

(k) [Not used]

(l) clients' trade exposures referred to in Article 305(2) or (3).

(m) [Not used]

(1A) Cash received under a credit linked note issued by the institution and loans and deposits of a counterparty to or with the institution which are subject to an on-balance sheet netting agreement recognised under Part 3, Title 2, Chapter 4 is deemed to fall under sub-paragraph (g).

(2) An institution may with GFSC approval treat as fully or partially exempt from the application of Article 395(1) the following types of exposures–

(a) to (b) [Not used]

(c) exposures incurred by an institution, including through participations or other kinds of holdings, to its parent undertaking, to other subsidiaries of that parent undertaking, or to its own subsidiaries and qualifying holdings, in so far as those undertakings are covered by the supervision on a consolidated basis to which the institution itself is subject, in accordance with these Standards, the Financial Services (Financial Conglomerates) Regulations 2020 or with equivalent standards in force in a country; exposures that do not meet those criteria, whether or not exempted from Article 395(1), are treated as exposures to a third party;

(d) to (f) [Not used]

(g) asset items constituting claims on central banks in the form of required minimum reserves held at those central banks which are denominated in their national currencies; and

(h) asset items constituting claims on central governments in the form of statutory liquidity requirements held in government securities which are denominated and funded in their national currencies if, at the discretion of the GFSC, the credit assessment of those central governments assigned by a nominated ECAI is investment grade.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(i) to (l) [Not used]

(3) [Not used]

(4) An institution must not simultaneously apply more than one exemption in paragraphs (1) and (2) to the same exposure.

Calculating the effect of the use of credit risk mitigation techniques.

401.(1) For calculating the value of exposures for the purposes of Article 395(1), an institution may use the fully adjusted exposure value (E*) as calculated under Chapter 4 of Title 2 of Part 3, taking into account the credit risk mitigation, volatility adjustments and any maturity mismatch referred to in that Chapter.

(2) With the exception of institutions using the Financial Collateral Simple Method, for the purposes of the first paragraph, institutions must use the Financial Collateral Comprehensive Method, regardless of the method used for calculating the own funds requirements for credit risk.

By way of derogation from paragraph (1), institutions with approval to use the methods referred to in Articles 218 to 236 and 283 to 294, may use those methods for calculating the exposure value of securities financing transactions.

(3) In calculating the value of exposures for the purposes of Article 395(1), institutions must conduct periodic stress tests of their credit-risk concentrations, including in relation to the realisable value of any collateral taken.

The periodic stress tests referred to in the first sub-paragraph must address risks arising from potential changes in market conditions that could adversely impact the institutions' adequacy of own funds and risks arising from the realisation of collateral in stressed situations. The stress tests carried out must be adequate and appropriate for the assessment of those risks.

An Institution's strategy to address concentration risk must include the following–

(a) policies and procedures to address risks arising from maturity mismatches between exposures and any credit protection on those exposures; and

(b) policies and procedures relating to concentration risk arising from the application of credit risk mitigation techniques, in particular from large indirect credit exposures, for example, exposures to a single issuer of securities taken as collateral.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(4) Where an institution reduces an exposure to a client using an eligible credit risk mitigation technique in accordance with Article 399(1), the institution, in the manner set out in Article 403, must treat the part of the exposure by which the exposure to the client has been reduced as having been incurred for the protection provider rather than for the client.

Exposures arising from mortgage lending.

402.(1) Subject to paragraph (2A), for the calculation of exposure values for the purposes of Article 395, institutions may reduce the value of an exposure or any part of an exposure that is fully secured by residential property in accordance with Article 125(1) by the pledged amount of the market value or mortgage lending value of the property concerned, but by not more than 50% of the market value or 60% of the mortgage lending value if rigorous criteria are in force at the time in Gibraltar for the assessment of the mortgage lending value, where all the following conditions are met–

(a) the GFSC has not set a risk weight higher than 35% for exposures or parts of exposures secured by residential property in accordance with Article 124(2);

(b) the exposure or part of the exposure is fully secured by any of the following–

(i) one or more mortgages on residential property; or

(ii) a residential property in a leasing transaction under which the lessor retains full ownership of the residential property and the lessee has not yet exercised his or her option to purchase;

(c) the requirements in Articles 208 and 229(1) are met.

(2) Subject to paragraph (2A), for the calculation of exposure values for the purposes of Article 395, an institution may-reduce the value of an exposure or any part of an exposure that is fully secured by commercial immovable property in accordance with Article 126(1) by the pledged amount of the market value or mortgage lending value of the property concerned, but not by more than 50% of the market value or 60% of the mortgage lending value if rigorous criteria are in force at the time in Gibraltar for the assessment of the mortgage lending value, where all the following conditions are met–

(a) the GFSC has not set a risk weight higher than 50% for exposures or parts of exposures secured by commercial immovable property in accordance with Article 124(2);

(b) the exposure is fully secured by any of the following–

(i) one or more mortgages on offices or other commercial premises; or

(ii) one or more offices or other commercial premises and the exposures related to property leasing transactions;

(c) the requirements in Article 126(2)(a), 208 and 229(1) are met;

(d) the commercial immovable property is fully constructed.

(2A) Paragraphs (1) and (2) only apply to an exposure or any part of an exposure that was entered into before 1st February 2026.

(3) An institution may treat an exposure to a counterparty that results from a reverse repurchase agreement under which the institution has purchased from the counterparty non-accessory independent mortgage liens on immovable property of third parties as a number of individual exposures to each of those third parties, if all of the following conditions are met–

(a) the counterparty is an institution or an investment firm;

(b) the exposure is fully secured by liens on the immovable property of those third parties that have been purchased by the institution and the institution is able to exercise those liens;

(c) the institution has ensured that the requirements in Article 208 and Article 229(1) are met;

(d) the institution becomes beneficiary of the claims that the counterparty has against the third parties in the event of default, insolvency or liquidation of the counterparty;

(e) the institution reports to the GFSC in accordance with Article 394 the total amount of exposures to each other institution or investment firm that are treated in accordance with this paragraph.

For these purposes, the institution must assume that it has an exposure to each of those third parties for the amount of the claim that the counterparty has on the third party instead of the corresponding amount of the exposure to the counterparty. The remainder of the exposure to the counter party, if any, must continue to be treated as an exposure to the counter party.

Substitution approach.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

403.(1) Where an exposure to a client is guaranteed by a third party or is secured by collateral issued by a third party, an institution may–

(a) treat the portion of the exposure which is guaranteed as exposure to the guarantor rather than to the client, if the unsecured exposure to the guarantor would be assigned a risk weight that is equal to or lower than the risk weight of the unsecured exposure to the client under Chapter 2 of Title 2 of Part 3;

(b) treat the portion of the exposure collateralised by the market value of recognised collateral as exposure to the third party rather than to the client, if the exposure is secured by collateral and if the collateralised portion of the exposure would be assigned a risk weight that is equal to or lower than the risk weight of the unsecured exposure to the client under Chapter 2 of Title 2 of Part 3.

The approach referred to in sub-paragraph (b) must not be used by an institution where there is a mismatch between the maturity of the exposure and the maturity of the protection.

For the purposes of this Part, an institution may use both the Financial Collateral Comprehensive Method and the treatment set out in sub-paragraph (b) only where it is permitted to use both the Financial Collateral Comprehensive Method and the Financial Collateral Simple Method for the purposes of Article 92.

(2) Where an institution applies paragraph (1)(a), the institution–

(a) where the guarantee is denominated in a currency different from that in which the exposure is denominated, must calculate the amount of the exposure that is deemed to be covered in accordance with the provisions on the treatment of currency mismatch for unfunded credit protection set out in Part 3;

(b) must treat any mismatch between the maturity of the exposure and the maturity of the protection in accordance with the provisions on the treatment of maturity mismatch set out in Chapter 4 of Title 2 of Part 3;

(c) may recognise partial coverage in accordance with the treatment set out in Chapter 4 of Title 2 of Part 3.

(3) For the purposes of paragraph (1)(b), an institution may replace the amount in sub-paragraph (a) with the amount in sub-paragraph (b) , if the conditions set out in sub-paragraphs (c), (d) and (e) are met–

(a) the total amount of the institution's exposure to a collateral issuer due to tri-party repurchase agreements facilitated by a tri-party agent;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(b) the full amount of the limits that the institution has instructed the tri-party agent referred to in sub-paragraph (a) to apply to the securities issued by the collateral issuer referred to in that sub-paragraph;

(c) the institution has verified that the tri-party agent has in place appropriate safeguards to prevent breaches of the limits referred to in sub-paragraph (b);

(d) the GFSC has not expressed to the institution any material concerns;

(e) the sum of the amount of the limit referred to in sub-paragraph (b) and any other exposures of the institution to the collateral issuer does not exceed the limit set out in Article 395(1).

404 to 410. [Not used]

PART 6
LIQUIDITY REQUIREMENTS

TITLE 1
DEFINITIONS AND LIQUIDITY COVERAGE REQUIREMENT

Definitions.

411. In this Part–

“asset coverage requirement” means the ratio of assets to liabilities as determined in accordance with the law of Gibraltar or a third country for credit enhancement purposes in relation to covered bonds;

“clearing member” means a clearing member as defined in Article 2(14) of EMIR;

“committed credit or liquidity facility” means–

(a) a “committed credit facility” which is a credit facility that is irrevocable or condition-ally revocable; or

(b) a “committed liquidity facility” which is a liquidity facility that is irrevocable or conditionally revocable;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

"deposit broker" means a natural person or an undertaking that places deposits from third parties, including retail deposits and corporate deposits but excluding deposits from financial institutions, with credit institutions in exchange of a fee;

"derivative contracts" means the derivative contracts listed in Schedule 2 and credit derivatives;

"factoring" means a contractual agreement between a business (the "assignor") and a financial entity (the "factor") in which the assignor assigns or sells its receivables to the factor in exchange for the factor providing the assignor with one or more of the following services with regard to the receivables assigned–

(a) an advance of a percentage of the amount of the assigned receivables, generally short term, uncommitted and without automatic roll-over;

(b) receivables management, collection and credit protection, whereby, in general, the factor administers the assignor's sales ledger and collects the receivables in the factor's own name; for the purposes of Title 4, factoring is treated as trade finance;

"financial customer" means a customer, including a financial customer belonging to a non-financial corporate group, which performs one or more of the activities listed in the Schedule to the CICR Regulations as its main business, or which is one of the following–

(a) a credit institution;

(b) an investment firm;

(c) a securitisation special purpose entity (SSPE);

(d) a collective investment undertaking (CIU);

(e) a non-open ended investment scheme;

(f) an insurance undertaking;

(g) a reinsurance undertaking;

(h) a financial holding company or mixed-financial holding company;

(i) a financial institution;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(j) a pension scheme arrangement as defined in Article 2(10) of EMIR;

"level 1 assets" means assets of extremely high liquidity and credit quality as referred to in the second sub-paragraph of Article 416(1);

"level 2 assets" means assets of high liquidity and credit quality as referred to in the second sub-paragraph of Article 416(1); level 2 assets are further subdivided into level 2A and 2B assets as set out in Part 4 of Schedule 4;

"liquidity buffer" means the amount of level 1 and level 2 assets that an institution holds in accordance with Part 4 of Schedule 4;

"margin loans" means collateralised loans extended to customers for the purpose of taking leveraged trading positions;

"net liquidity outflows" means the amount which results from deducting an institution's liquidity inflows from its liquidity outflows;

"non-mandatory over-collateralisation" means any amount of assets which the institution is not obliged to attach to a covered bond issuance by virtue of legal or regulatory requirements, contractual commitments or for reasons of market discipline, including in particular where the assets are provided in excess of the minimum legal, statutory or regulatory over-collateralisation requirement applicable to the covered bonds under the law of Gibraltar or a third country;

"personal investment company" or "PIC" means an undertaking or a trust, the owner or beneficial owner of which is either a natural person or a group of closely related natural persons which does not carry out any other commercial, industrial or professional activity and which was set up with the sole purpose of managing the wealth of the owner or owners, including ancillary activities such as segregating the owners' assets from corporate assets, facilitating the transmission of assets within a family or preventing a split of the assets after the death of a member of the family, if those ancillary activities are connected to the main purpose of managing the owners' wealth;

"reporting currency" means sterling or the currency in which the institution's annual accounts are prepared;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

"retail deposit" means a liability to a natural person or to a SME, where the SME would qualify for the retail exposure class under the standardised or IRB approaches for credit risk, or a liability to a company which is eligible for the treatment set out in Article 153(4), and where the aggregate deposits by that SME or company on a group basis do not exceed £880,000;

"stress" (and "stressed") mean a sudden or severe deterioration in the solvency or liquidity position of an institution due to changes in market conditions or idiosyncratic factors as a result of which there is a significant risk that the institution becomes unable to meet its commitments as they become due within the next 30 days;

"unencumbered assets" (and "unencumbered") mean assets which are not subject to any legal, contractual, regulatory or other restriction preventing the institution from liquidating, selling, transferring, assigning or, generally, disposing of those assets via an outright sale or a repurchase agreement.

Liquidity coverage requirement.

412.(1) Institutions must hold liquid assets, the sum of the values of which covers the liquidity outflows less the liquidity inflows under stressed conditions so as to ensure that institutions maintain levels of liquidity buffers which are adequate to face any possible imbalance between liquidity inflows and outflows under gravely stressed conditions over a period of thirty days. During times of stress, institutions may use their liquid assets to cover their net liquidity outflows.

(2) Institutions must not double count liquidity outflows, liquidity inflows and liquid assets. Unless specified otherwise in Part 4 of Schedule 4, where an item can be counted in more than one outflow category, it must be counted in the outflow category that produces the greatest contractual outflow for that item.

(3) Institutions may use the liquid assets referred to in paragraph (1) to meet their obligations under stressed circumstances as specified under Article 414.

(4) The provisions set out in Title 2 must apply exclusively for the purposes of specifying reporting obligations set out in Article 415.

(4A) [Not used]

(5) [Not used]

Stable funding requirement.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

413.(1) Institutions must ensure that long term assets and off-balance-sheet items are adequately met with a diverse set of funding instruments that are stable under both normal and stressed conditions.

(2) The provisions set out in Title 3 must apply exclusively for the purpose of specifying reporting obligations set out in Article 415.

(3) The provisions set out in Title 4 apply for the purpose of specifying the stable funding requirement set out in paragraph (1) and reporting obligations for institutions set out in Article 415.

Compliance with liquidity requirements.

414. An institution that does not meet, or does not expect to meet, the requirements set out in Article 412 or 413(1), including during times of stress, must–

(a) immediately notify the GFSC of that fact; and

(b) submit to the GFSC without undue delay a plan for the timely restoration of compliance with the requirements set out in Article 412, 413(1) or 428B(2), as appropriate.

Until compliance has been restored, the institution must report the items referred to in Title 3, in Title 4, in the Commission Implementing Regulation (EU) 680/2014 and in Part 4 of Schedule 4, as appropriate, daily by the end of each business day, unless the GFSC authorises a lower reporting frequency and a longer reporting delay. The GFSC must only grant such authorisations on the basis of the individual situation of the institution, taking into account the scale and complexity of the institution's activities. The GFSC must monitor the implementation of such restoration plan and must require a more rapid restoration of compliance where appropriate.

TITLE 2
LIQUIDITY REPORTING

Reporting obligation and reporting format.

415.(1) Institutions must report the items referred to in Commission Implementing Regulation (EU) 680/2014, in Title 4 and in Part 4 of Schedule 4to the GFSC in the reporting currency, regardless of the actual denomination of those items.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

The reporting frequency must be at least monthly for items referred to in Part 4 of Schedule 4and at least quarterly for items referred to in Titles 3 and 4.

(2) An institution must report separately to the GFSC the items referred to in Commission Implementing Regulation (EU) 680/2014, in Title 3, in Title 4 and in Part 4 of Schedule 4, as appropriate, in accordance with the following–

(a) where items are denominated in a currency other than the reporting currency and the institution has aggregate liabilities denominated in such a currency which amount to or exceed 5% of the institution's or the single liquidity sub-group's total liabilities, excluding own funds and off-balance-sheet items, reporting must be done in the currency of denomination;

(b) where items are denominated in the reporting currency, and the aggregate amount of liabilities in other currencies than the reporting currency amounts to or exceeds 5% of the institution's or the single liquidity subgroup's total liabilities, excluding own funds and off-balance-sheet items, the reporting must be done in the reporting currency.

(3) [Not used]

(4) Schedule 3 specifies the liquid asset items which are subject to supplementary reporting.

Reporting on liquid assets.

416.(1) Institutions must report the following as liquid assets unless excluded by paragraph (2) and only if the liquid assets fulfil the conditions in paragraph (3)–

(a) cash and exposures to central banks to the extent that these exposures can be withdrawn at any time in times of stress. As regards deposits held with central banks, the GFSC and the central bank must aim at reaching a common understanding regarding the extent to which minimum reserves can be withdrawn in times of stress;

(b) other transferable assets that are of extremely high liquidity and credit quality;

(c) transferable assets representing claims on or guaranteed by–

(i) the government of Gibraltar or the central government (or regional government with fiscal autonomy to raise and collect taxes) of a third country in the domestic currency of the central or regional government, if

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

the institution incurs a liquidity risk in Gibraltar or the third country that it covers by holding those liquid assets;

(ii) central banks and non-central government public sector entities in the domestic currency of the central bank and the public sector entity;

(iii) the Bank for International Settlements, the International Monetary Fund and multilateral development banks;

(iv) the European Financial Stability Facility and the European Stability Mechanism;

(d) transferable assets that are of high liquidity and credit quality;

(e) standby credit facilities granted by central banks within the scope of monetary policy to the extent that these facilities are not collateralised by liquid assets and excluding emergency liquidity assistance;

(f) if the credit institution belongs to a network in accordance with legal or statutory provisions, the legal or statutory minimum deposits with the central credit institution and other statutory or contractually available liquid funding from the central credit institution.

(2) The following must not be considered liquid assets–

(a) assets that are issued by a credit institution unless they fulfil one of the following conditions–

(i) they are bonds eligible for the treatment set out in Article 129(4) or (5) or asset backed instruments if demonstrated to be of the highest credit quality as set out in Part 4 of Schedule 4;

(ii) they are CRR covered bonds other than those referred to in paragraph (i);

(iii) the credit institution has been set up by the government of Gibraltar and that government has an obligation to protect the economic basis of the institution and maintain its viability throughout its lifetime; or the asset is explicitly guaranteed by that government; or at least 90% of the loans granted by the institution are directly or indirectly guaranteed by that government and the asset is predominantly used to fund promotional loans granted on a non-competitive, not for profit basis in order to promote that government's public policy objectives;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(b) assets that are provided as collateral to the institution under reverse repo and securities financing transactions and that are held by the institution only as a credit risk mitigant and that are not legally and contractually available for use by the institution;

(i) assets issued by any of the following–

(ii) an investment firm;

(iii) an insurance undertaking;

(iv) a financial holding company;

(v) a mixed financial holding company;

(vi) any other entity that performs one or more of the activities listed in the Schedule to the CICR Regulations as its main business.

(3) In accordance with paragraph (1), institutions must report assets that fulfil the following conditions as liquid assets–

(a) the assets are unencumbered or stand available within collateral pools to be used for obtaining additional funding under committed or, where the pool is operated by a central bank, uncommitted but not yet funded credit lines available to the institution;

(b) the assets are not issued by the institution itself, by its parent or subsidiary institutions, or by another subsidiary of its parent institution or parent financial holding company;

(c) the price of the assets is generally agreed upon by market participants and can easily be observed in the market or the price can be determined by a formula that is easy to calculate on the basis of publicly available inputs and that does not depend on strong assumptions, as is typically the case for structured or exotic products;

(d) the assets are listed on a recognised exchange or they are tradable by an outright sale or via a simple repurchase agreement on repurchase markets; those criteria must be assessed separately for each market.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

The conditions referred to in sub-paragraphs (c) and (d) must not apply to the assets referred to in paragraph (1)(a), (e) and (f).

(4) [Not used]

(5) Shares or units in CIUs may be treated as liquid assets, up to an absolute amount of £440 million or the equivalent amount in domestic currency, in the portfolio of liquid assets of each institution, if the requirements laid down in Article 132(3) are met and that the CIU only invests in liquid assets as referred to in paragraph (1), apart from derivatives to mitigate interest rate or credit or currency risk.

The use or potential use by a CIU of derivative instruments to hedge risks of permitted investments must not prevent that CIU from being eligible for the treatment referred to in the first sub-paragraph. Where the value of the shares or units of the CIU is not regularly marked to market by the third parties referred to in Article 418(4)(a) and (b) and where an institution has not developed robust methodologies and processes for such valuation as referred to in Article 418(4), shares or units in that CIU must not be treated as liquid assets.

(6) Where a liquid asset ceases to comply with the requirement for liquid assets as set out in this Article, an institution may nevertheless continue to consider it a liquid asset for an additional period of 30 days. Where a liquid asset in a CIU ceases to be eligible for the treatment set out in paragraph (5), the shares or units in the CIU may nevertheless be considered a liquid asset for an additional period of 30 days, if those assets do not exceed 10% of the CIU's overall assets.

Operational requirements for holdings of liquid assets.

417. The institution must only report as liquid assets those holdings of liquid assets that meet the following conditions–

(a) they are appropriately diversified. Diversification is not required in terms of assets corresponding to Article 416(1)(a), (b) and (c);

(b) they are legally and practically readily available at any time during the next 30 days to be liquidated via outright sale or via a simple repurchase agreement on approved repurchase markets in order to meet obligations coming due. Liquid assets referred to Article 416(1)(c) which are held in third countries where there are transfer restrictions or which are denominated in non-convertible currencies must be considered available only to the extent that they correspond to outflows in the third country or currency in question, unless the institution can demonstrate to the GFSC that it has appropriately hedged the ensuing currency risk;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(c) the liquid assets are controlled by a liquidity management function;

(d) a portion of the liquid assets except those referred to in Article 416(1)(a), (c), (e) and (f) is periodically and at least annually liquidated via outright sale or via simple repurchase agreements on an approved repurchase market for the following purposes–

(i) to test the access to the market for these assets;

(ii) to test the effectiveness of its processes for the liquidation of assets;

(iii) to test the usability of the assets;

(iv) to minimise the risk of negative signalling during a period of stress;

(e) price risks associated with the assets may be hedged but the liquid assets are subject to appropriate internal arrangements that ensure that they are readily available to the treasury when needed and especially that they are not used in other ongoing operations, including–

(i) hedging or other trading strategies;

(ii) providing credit enhancements in structured transactions;

(iii) covering operational costs;

(f) the denomination of the liquid assets is consistent with the distribution by currency of liquidity outflows after the deduction of inflows.

Valuation of liquid assets.

418.(1) The value of a liquid asset to be reported must be its market value, subject to appropriate haircuts that reflect at least the duration, the credit and liquidity risk and typical repo haircuts in periods of general market stress. The haircuts must not be less than 15% for the assets referred to in Article 416(1)(d). If the institution hedges the price risk associated with an asset, it must take into account the cash flow resulting from the potential close-out of the hedge.

(2) Shares or units in CIUs as referred to in Article 416(6) must be subject to haircuts, looking through to the underlying assets as follows–

(i) 0% for the assets referred to in Article 416(1)(a);

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(ii) 5% for the assets referred to in Article 416(1)(b) and (c);

(iii) 20% for the assets referred to in Article 416(1)(d).

(3) The look-through approach referred to in paragraph (2) must be applied as follows–

(a) where the institution is aware of the underlying exposures of a CIU, it may look through to those underlying exposures in order to assign them to Article 416(1)(a) to (d);

(b) where the institution is not aware of the underlying exposures of a CIU, it must be assumed that the CIU invests, to the maximum extent allowed under its mandate, in descending order in the asset types referred to in Article 416(1)(a) to (d) until the maximum total investment limit is reached.

(4) Institutions must develop robust methodologies and processes to calculate and report the market value and haircuts for shares or units in CIUs. Only where the materiality of the exposure does not justify the development of their own methodologies, institutions may rely on the following third parties to calculate and report the haircuts for shares or units in CIUs, in accordance with the methods set out in paragraph (3)(a) and (b)–

(a) the depository institution of the CIU if the CIU exclusively invests in securities and deposits all securities at this depository institution;

(b) for other CIUs, the CIU management company.

The correctness of the calculations by the depository institution or the CIU management company must be confirmed by an external auditor.

Currencies with constraints on the availability of liquid assets.

419.(1) [Not used]

(2) Where the justified needs for liquid assets in light of the requirement in Article 412 exceed the availability of those liquid assets in a currency, one or more of the following derogations must apply–

(a) by way of derogation from Article 417(f), the denomination of the liquid assets may be inconsistent with the distribution by currency of liquidity outflows after the deduction of inflows;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(b) for currencies of third countries, required liquid assets may be substituted by credit lines from the central bank of that third country which are contractually irrevocably committed for the next 30 days and are fairly priced, independent of the amount currently drawn, if the competent authorities of that third country do the same and if that third country has comparable reporting requirements in place;

(c) where there is a deficit of level 1 assets, additional level 2A assets may be held by the institution, subject to higher haircuts, and any cap applicable to those assets in accordance with Part 4 of Schedule 4may be amended.

(3) The derogations applied in accordance with paragraph (2) must be inversely proportional to the availability of the relevant assets. The justified needs of institutions must be assessed taking into account their ability to reduce, by sound liquidity management, the need for those liquid assets and the holdings of those assets by other market participants.

(4) [Not used]

Liquidity outflows.

420.(1) [Not used]

(2) Institutions must regularly assess the likelihood and potential volume of liquidity outflows during the next 30 days as far as products or services are concerned, which are not captured in Articles 422, 423 and 424 and which they offer or sponsor or which potential purchasers would consider to be associated with them, including but not limited to liquidity outflows resulting from any contractual arrangements such as other off-balance sheet and contingent funding obligations, including, but not limited to committed funding facilities, undrawn loans and advances to wholesale counterparties, mortgages that have been agreed but not yet drawn down, credit cards, overdrafts, planned outflows related to renewal or extension of new retail or wholesale loans, planned derivative payables and trade finance off-balance sheet related products, as referred to in Article 429 and in Schedule 1. These outflows must be assessed under the assumption of a combined idiosyncratic and market-wide stress scenario.

For this assessment, institutions must take particular account of material reputational damage that could result from not providing liquidity support to such products or services. Institutions must report at least once a year to the GFSC those products and services for which the likelihood and potential volume of the liquidity outflows referred to in the first sub-paragraph are material and institutions must assign appropriate outflows.

Outflows on retail deposits.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

421.(1) Institutions must separately report the amount of retail deposits covered by the Gibraltar deposit guarantee scheme or an equivalent deposit guarantee scheme in a third country, and multiply by at least 5% where the deposit is either of the following–

(a) part of an established relationship making withdrawal highly unlikely;

(b) held in a transactional account, including accounts to which salaries are regularly credited.

(2) Institutions must multiply other retail deposits not referred to in paragraph (1) by at least 10%.

(3) [Not used]

(4) Despite paragraphs (1) and (2), institutions must multiply retail deposits that they have taken in third countries by a higher percentage than provided for in those paragraphs if such percentage is provided by comparable third country reporting requirements.

(5) Institutions may exclude from the calculation of outflows certain clearly circumscribed categories of retail deposits as long as in each and every instance the institution rigorously applies the following for the whole category of those deposits, unless in individually justified circumstances of hardship for the depositor–

(a) within 30 days, the depositor is not allowed to withdraw the deposit; or

(b) for early withdrawals within 30 days, the depositor has to pay a penalty that includes the loss of interest between the date of withdrawal and the contractual maturity date plus a material penalty that does not have to exceed the interest due for the time elapsed between the date of deposit and the date of withdrawal.

Outflows on other liabilities.

422.(1) Institutions must multiply liabilities resulting from the institution's own operating expenses by 0%.

(2) Institutions must multiply liabilities resulting from secured lending and capital market-driven transactions as defined in Article 192 by–

(a) 0% up to the value of the liquid assets in accordance with Article 418 if they are collateralised by assets that would qualify as liquid assets in accordance with Article 416;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(b) 100% over the value of the liquid assets in accordance with Article 418, if they are collateralized by assets that would qualify as liquid assets in accordance with Article 416;

(c) 100% if they are collateralized by assets that would not qualify as liquid assets in accordance with Article 416, with the exception of transactions covered by sub-paragraphs (d) and (e);

(d) 25% if they are collateralized by assets that would not qualify as liquid assets in accordance with Article 416 and the lender is the government of Gibraltar, a Gibraltar public sector entity or a multilateral development bank. Public sector entities that receive that treatment must be limited to those that have a risk weight of 20% or lower in accordance with Chapter 2, Title 2 of Part 3;

(e) 0% if the lender is a central bank.

(3) Institutions must multiply liabilities resulting from deposits that have to be maintained–

(a) by the depositor in order to obtain clearing, custody or cash management or other comparable services from the institution;

(b) [Not used]

(c) by the depositor in the context of an established operational relationship other than that mentioned in sub-paragraph (a);

(d) by the depositor to obtain cash clearing and central credit institution services and where the credit institution belongs to a network in accordance with legal or statutory provisions;

(e) by 5% in the case of sub-paragraph (a) to the extent to which they are covered by the Gibraltar deposit guarantee scheme or an equivalent deposit guarantee scheme in a third country and by 25% otherwise.

Deposits from credit institutions placed at central credit institutions that are considered as liquid assets in accordance with Article 416(1)(f) must be multiplied by 100% outflow rate.

(4) Clearing, custody, cash management or other comparable services referred to in paragraph (3)(a) and (d) must only cover those services to the extent that those services are rendered in the context of an established relationship on which the depositor has substantial dependence. Those services must not merely consist of correspondent banking or prime brokerage services, and institutions must have evidence that the client is unable to withdraw

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

amounts legally due over a 30-day time horizon without compromising its operational functioning.

(5) Institutions must multiply liabilities resulting from deposits by clients that are not financial customers to the extent they do not fall under paragraphs (3) and (4) by 40% and must multiply the amount of these liabilities covered by the Gibraltar deposit guarantee scheme or an equivalent Deposit Guarantee Scheme in a third country by 20%.

(6) Institutions must take outflows and inflows expected over the 30 day horizon from the contracts listed in Schedule 2 into account on a net basis across counterparties and must multiply them by 100% in the case of a net outflow. Net basis must mean also net of collateral to be received that qualifies as liquid assets under Article 416.

(7) Institutions must separately report other liabilities that do not fall under paragraphs (1) to (5).

(8) The GFSC may grant the approval to apply a lower outflow percentage to the liabilities referred to in paragraph (7) on a case-by-case basis, if all the following conditions are met–

(a) the counterparty is–

(i) a parent or subsidiary institution of the institution, or a parent or subsidiary investment firm of the institution, or another subsidiary of the same parent institution or parent investment firm; or

(ii) linked to the institution by a common management relationship;

(iii) [Not used]

(b) a corresponding symmetric or more conservative inflow is applied by the counterparty by way of derogation from Article 425; and

(c) the institution and the counterparty are established in Gibraltar.

Additional outflows.

423.(1) Collateral other than assets referred to in Article 416(1)(a), (b) and (c), which is posted by the institution for contracts listed in Schedule 2 and credit derivatives, must be subject to an additional outflow of 20%.

(2) An institution must notify the GFSC of all contracts entered into of which the contractual conditions lead to liquidity outflows or additional collateral needs, within 30 days after a

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

material deterioration of the institution's credit quality. Where those contracts are material in relation to the potential liquidity outflows of the institution, the institution must add an appropriate additional outflow for those contracts, which must correspond to the additional collateral needs resulting from a material deterioration in its credit quality, such as a downgrade in its external credit assessment. The institution must regularly review the extent of that material deterioration in light of what is relevant under the contracts it has entered into, and must notify the result of its review to the GFSC.

(3) The institution must add an additional outflow which must correspond to the collateral needs that would result from the impact of an adverse market scenario on its derivatives transactions if material.

(4) The institution must add an additional outflow corresponding to the market value of securities or other assets sold short and to be delivered within the 30 days horizon unless the institution owns the securities to be delivered or has borrowed them at terms requiring their return only after the 30 day horizon and the securities do not form part of the institutions liquid assets.

(5) The institution must add an additional outflow corresponding to–

(a) the excess collateral the institution holds that can be contractually called at any time by the counterparty;

(b) collateral that is due to be returned to a counterparty;

(c) collateral that corresponds to assets that would qualify as liquid assets for the purposes of Article 416 that can be substituted for assets corresponding to assets that would not qualify as liquid assets for the purposes of Article 416 without the consent of the institution.

(6) Deposits received as collateral must not be considered liabilities for the purposes of Article 422 but will be subject to the provisions of this Article where applicable.

Outflows from credit and liquidity facilities.

424.(1) Institutions must report outflows from committed credit facilities and committed liquidity facilities, which must be determined as a percentage of the maximum amount that can be drawn within the next 30 days. This maximum amount that can be drawn may be assessed net of any liquidity requirement that would be mandated under Article 420(2) for the trade finance off-balance sheet items and net of the value in accordance with Article 418 of collateral to be provided if the institution can reuse the collateral and if the collateral is held in the form of liquid assets in accordance with Article 416. The collateral to be provided must

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

not be assets issued by the counterparty of the facility or one of its affiliated entities. If the necessary information is available to the institution, the maximum amount that can be drawn for credit and liquidity facilities must be determined as the maximum amount that could be drawn given the counterparty's own obligations or given the pre-defined contractual drawdown schedule coming due over the next 30 days.

(2) The maximum amount that can be drawn of undrawn committed credit facilities and undrawn committed liquidity facilities within the next 30 days must be multiplied by 5% if they qualify for the retail exposure class under the Standardised or IRB approaches for credit risk.

(3) The maximum amount that can be drawn of undrawn committed credit facilities and undrawn committed liquidity facilities within the next 30 days must be multiplied by 10% where they meet the following conditions–

(a) they do not qualify for the retail exposure class under the Standardised or IRB approaches for credit risk;

(b) they have been provided to clients that are not financial customers;

(c) they have not been provided for the purpose of replacing funding of the client in situations where he is unable to obtain its funding requirements in the financial markets.

(4) The committed amount of a liquidity facility that has been provided to an SSPE for the purpose of enabling that SSPE to purchase assets, other than securities, from clients that are not financial customers must be multiplied by 10%, if the committed amount exceeds the amount of assets currently purchased from clients and that the maximum amount that can be drawn is contractually limited to the amount of assets currently purchased.

(5) The institutions must report the maximum amount that can be drawn of other undrawn committed credit facilities and undrawn committed liquidity facilities within the next 30 days. This applies in particular to the following–

(a) liquidity facilities that the institution has granted to SSPEs other than those referred to in paragraph (3)(b);

(b) arrangements under which the institution is required to buy or swap assets from an SSPE;

(c) facilities extended to credit institutions;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(d) facilities extended to financial institutions and investment firms.

(6) By way of derogation from paragraph (5), institutions which have been set up and are sponsored by the government of Gibraltar may apply the treatments set out in paragraphs (2) and (3) also to credit and liquidity facilities that are provided to institutions for the sole purpose of directly or indirectly funding promotional loans qualifying for the exposure classes referred to in those paragraphs. By way of derogation from Article 425(2)(g), where those promotional loans are extended via another institution as intermediary (pass through loans), a symmetric in and outflow may be applied by institutions. Those promotional loans must be available only to persons who are not financial customers on a non-competitive, not for profit basis in order to promote public policy objectives of the government. It must only be possible to draw on such facilities following the reasonably expected demand for a promotional loan and up to the amount of such demand linked to a subsequent reporting on the use of the funds disbursed.

Inflows.

425.(1) Institutions must report their liquidity inflows. Capped liquidity inflows must be the liquidity inflows limited to 75% of liquidity outflows. Institutions may exempt liquidity inflows from deposits placed with other institutions and qualifying for the treatments set out in Article 113(6) from this limit. Institutions may exempt liquidity inflows from monies due from borrowers and bond investors related to mortgage lending funded by bonds eligible for the treatment set out in Article 129(4), (5) or (6) or by CRR covered bonds from this limit. Institutions may exempt inflows from promotional loans that the institutions have passed through. Subject to the prior approval of the GFSC, the institution may fully or partially exempt inflows where the provider is a parent or a subsidiary institution of the institution or another subsidiary of the same parent institution or linked to the institution by a common management relationship.

(2) The liquidity inflows must be measured over the next 30 days. They must comprise only contractual inflows from exposures that are not past due and for which the institution has no reason to expect non-performance within the 30-day time horizon. Liquidity inflows must be reported in full with the following inflows reported separately–

(a) monies due from customers that are not financial customers for the purposes of principal payment must be reduced by 50% of their value or by the contractual commitments to those customers to extend funding, whichever is higher. This does not apply to monies due from secured lending and capital market-driven transactions as defined in Article 192(3) that are collateralised by liquid assets in accordance with Article 416 as referred to in sub-paragraph (d).

By way of derogation from the first sub-paragraph, institutions that have received a commitment referred to in Article 424(6) in order for them to disburse a

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

promotional loan to a final recipient may take an inflow into account up to the amount of the outflow they apply to the corresponding commitment to extend those promotional loans;

(b) monies due from trade financing transactions referred to in the second sub-paragraph of Article 162(3)(b) with a residual maturity of up to 30 days, must be taken into account in full as inflows;

(c) loans with an undefined contractual end date must be taken into account with a 20% inflow, if the contract allows the institution to withdraw and request payment within 30 days;

(d) monies due from secured lending and capital market-driven transactions as defined in Article 192(3) if they are collateralised by liquid assets as referred to in Article 416(1), must not be taken into account up to the value net of haircuts of the liquid assets and must be taken into account in full for the remaining monies due;

(e) monies due that the institution owing those monies treats in accordance with Article 422(3) and (4), must be multiplied by a corresponding symmetrical inflow;

(f) monies due from positions in major index equity instruments if there is no double counting with liquid assets;

(g) any undrawn credit or liquidity facilities and any other commitments received must not be taken into account.

(3) Outflows and inflows expected over the 30 day horizon from the contracts listed in Schedule 2 must be reflected on a net basis across counterparties and must be multiplied by 100% in the event of a net inflow. Net basis must mean also net of collateral to be received that qualifies as liquid assets under Article 416.

(4) By way of derogation from paragraph (2)(g), the GFSC may grant the approval to apply a higher inflow on a case by case basis for credit and liquidity facilities when all of the following conditions are fulfilled–

(a) there are reasons to expect a higher inflow even under a combined market and idiosyncratic stress of the provider;

(b) the counterparty is a Gibraltar parent or subsidiary institution of the institution or another subsidiary of the same parent institution or linked to the institution by a common management relationship;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(c) a corresponding symmetric or more conservative outflow is applied by the counterparty by way of derogation from Articles 422, 423 and 424;

(d) the institution and the counterparty are established in Gibraltar.

(5) to (6) [Not used]

(7) Institutions must not report inflows from any of the liquid assets reported in accordance with Article 416 other than payments due on the assets that are not reflected in the market value of the asset.

(8) Institutions must not report inflows from any new obligations entered into.

(9) Institutions must take liquidity inflows which are to be received in third countries where there are transfer restrictions or which are denominated in non-convertible currencies into account only to the extent that they correspond to outflows respectively in the third country or currency in question.

426. [Not used]

TITLE 3
REPORTING ON STABLE FUNDING

Items providing stable funding.

427.(1) Institutions must report to the GFSC, in accordance with the reporting requirements set out in Article 415(1) and the uniform reporting formats referred to in Article 415(3), the following items and their components in order to allow an assessment of the availability of stable funding–

(a) the following own funds, after deductions have been applied, where appropriate–

(i) tier 1 capital instruments;

(ii) tier 2 capital instruments;

(iii) other preferred shares and capital instruments in excess of Tier 2 allowable amount having an effective maturity of one year or greater;

(b) the following liabilities not included in sub-paragraph (a)–

(i) retail deposits that qualify for the treatment set out in Article 421(1);

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(ii) retail deposits that qualify for the treatment set out in Article 421(2);

(iii) deposits that qualify for the treatment set out in Article 422(3) and (4);

(iv) of the deposits referred to in paragraph (iii), those that are subject to the Gibraltar deposit guarantee scheme or an equivalent deposit guarantee scheme in a third country deposit guarantees within the terms of Article 421(1);

(v) [Not used]

(vi) of the deposits referred to in paragraph (iii), those that fall under Article 422(3)(d);

(vii) amounts deposited not falling under paragraph (i), (ii) or (iii) if they are not deposited by financial customers;

(viii) all funding obtained from financial customers;

(ix) separately for amounts falling under paragraphs (vii) and (viii) respectively, funding from secured lending and capital market-driven transactions as defined in Article 192(3)–

(aa) collateralised by assets that would qualify as liquid assets in accordance with Article 416;

(bb) collateralised by any other assets;

(x) liabilities resulting from securities issued qualifying for the treatment set out in Article 129(4) or (5) or CRR covered bonds;

(xi) the following other liabilities resulting from securities issued that do not fall under sub-paragraph (a) –

(aa) liabilities resulting from securities issued with an effective maturity of one year or greater;

(bb) liabilities resulting from securities issued with an effective maturity of less than one year;

(xii) any other liabilities.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(2) Where applicable, all items must be presented in the following five buckets according to the closest of their maturity date and the earliest date at which they can contractually be called–

(a) within three months;

(b) between three and six months;

(c) between six and nine months;

(d) between nine and 12 months;

(e) after 12 months.

Items requiring stable funding.

428.(1) Unless deducted from own funds, the following items must be reported to the GFSC separately in order to allow an assessment of the needs for stable funding–

(a) the assets that would qualify as liquid assets in accordance with Article 416, broken down by asset type;

(b) the following securities and money market instruments not included in sub-paragraph (a) –

(i) assets qualifying for credit step 1 under Article 122;

(ii) assets qualifying for credit step 2 under Article 122;

(iii) other assets;

(c) equity securities of non-financial entities listed on a major index in a recognised exchange;

(d) other equity securities;

(e) gold;

(f) other precious metals;

(g) non-renewable loans and receivables, and separately those non-renewable loans and receivables for which borrowers are–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(i) natural persons other than commercial sole proprietors and partnerships;

(ii) SMEs that qualify for the retail exposure class under the Standardised or IRB approaches for credit risk or to a company which is eligible for the treatment set out in Article 153(4) and where the aggregate deposit placed by that client or group of connected clients is less than £880,000;

(iii) sovereigns, central banks and public sector entities;

(iv) clients not referred to in paragraphs (i) and (ii) other than financial customers;

(v) clients not referred to in paragraphs (i), (ii) and (iii) that are financial customers, and thereof separately those that are credit institutions and other financial customers;

(h) non-renewable loans and receivables referred to in sub-paragraph (g), and thereof separately those that are–

(i) collateralised by commercial immovable property (CRE);

(ii) collateralised by residential property (RRE);

(iii) match funded (pass-through) via bonds eligible for the treatment set out in Article 129(4) or (5) or via CRR covered bonds;

(i) derivatives receivables;

(j) any other assets;

(k) undrawn committed credit facilities that qualify as “medium risk” or “medium/low risk” under Schedule 1.

(2) Where applicable, all items must be presented in the five buckets described in Article 427(2).

TITLE 4
THE NET STABLE FUNDING RATIO

CHAPTER 1
THE NET STABLE FUNDING RATIO

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Application on a consolidated basis.

428A. Where the net stable funding ratio set out in this Title applies on a consolidated basis in accordance with Article 11(4), the following provisions must apply–

(a) the assets and off-balance-sheet items of a subsidiary having its head office in a third country which are subject to required stable funding factors under the net stable funding requirement set out in the law of that third country that are higher than those specified in Chapter 4 must be subject to consolidation in accordance with the higher factors specified in the law of that third country;

(b) the liabilities and own funds of a subsidiary having its head office in a third country which are subject to available stable funding factors under the net stable funding requirement set out in the law of that third country that are lower than those specified in Chapter 3 must be subject to consolidation in accordance with the lower factors specified in the law of that third country;

(c) third-country assets which meet the requirements laid down in Part 4 of Schedule 4and which are held by a subsidiary having its head office in a third country must not be recognised as liquid assets for consolidation purposes where they do not qualify as liquid assets under the law of that third country which sets out the liquidity coverage requirement.

The net stable funding ratio.

428B.(1) The net stable funding requirement laid down in Article 413(1) must be equal to the ratio of the institution's available stable funding as referred to in Chapter 3 to the institution's required stable funding as referred to in Chapter 4, and must be expressed as a percentage. Institutions must calculate their net stable funding ratio in accordance with the following formula–

$$\frac{\text{Available stable funding}}{\text{Required stable funding}} = \text{Net stable funding ratio } (\%)$$

(2) Institutions must maintain a net stable funding ratio of at least 100%, calculated in the reporting currency for all their transactions, irrespective of their actual currency denomination.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(3) Where, at any time, the net stable funding ratio of an institution has fallen below 100%, or can be reasonably expected to fall below 100%, the requirement laid down in Article 414 must apply. The institution must aim to restore its net stable funding ratio to the level referred to in paragraph (2).

(4) Institutions must calculate and monitor their net stable funding ratio in the reporting currency for all their transactions, irrespective of their actual currency denomination, and separately for their transactions denominated in each of the currencies that is subject to separate reporting in accordance with Article 415(2).

(5) Institutions must ensure that the distribution of their funding profile by currency denomination is generally consistent with the distribution of their assets by currency.

CHAPTER 2
GENERAL RULES FOR THE CALCULATION OF THE NET STABLE FUNDING RATIO

Calculation of the net stable funding ratio.

428C.(1) Unless otherwise specified in this Title, institutions must take into account assets, liabilities and off-balance-sheet items on a gross basis.

(2) For the purpose of calculating their net stable funding ratio, institutions must apply the appropriate stable funding factors set out in Chapters 3 and 4 to the accounting value of their assets, liabilities and off-balance-sheet items, unless otherwise specified in this Title.

(3) Institutions must not double count required stable funding and available stable funding.

Unless otherwise specified in this Title, where an item can be allocated to more than one required stable funding category, it must be allocated to the required stable funding category that produces the greatest contractual required stable funding for that item.

Derivative contracts.

428D.(1) Institutions must apply this Article to calculate the amount of required stable funding for derivative contracts as referred to in Chapters 3 and 4.

(2) Without prejudice to Article 428AH(2), institutions must take into account the fair value of derivative positions on a net basis where those positions are included in the same netting set that fulfils the requirements set out in Article 429C(1). Where that is not the case, institutions must take into account the fair value of derivative positions on a gross basis and must treat those derivative positions as belonging to their own netting set for the purposes of Chapter 4.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(2A) For the purposes of paragraph (2), institutions may take into account the effects of contracts for novation and other netting agreements in accordance with Article 295. Institutions must not take into account cross-product netting, but may net within the product category as referred to in Article 272 and credit derivatives where they are subject to a contractual cross-product netting agreement as referred to in Article 295(c).

(3) For the purposes of this Title, the "fair value of a netting set" means the sum of the fair values of all the transactions included in a netting set.

(4) Without prejudice to Article 428AH(2), all derivative contracts listed in paragraphs 2(a) to (e) of Schedule 2 that involve a full exchange of principal amounts on the same date must be calculated on a net basis across currencies, including for the purpose of reporting in a currency that is subject to separate reporting in accordance with Article 415(2), even where those transactions are not included in the same netting set that fulfils the requirements set out in Article 429C(1).

(5) Cash received as collateral to mitigate the exposure of a derivative position must be treated as such and not treated as deposits to which Chapter 3 applies.

Derivative Client Clearing.

428DA.(1) This Article applies to initial margin, variation margin and derivatives assets and liabilities that are directly linked to derivative client clearing activities with a QCCP where the institution acts as clearing member, where–

(a) the initial margin includes–

(i) all amounts posted to the QCCP; and

(ii) amounts in excess of the amount posted to a QCCP only to the extent that such amounts are segregated from the assets of the institution and, as a result of that segregation, are not available to the institution freely to dispose of or exchange; and

(b) the institution does not provide to its clients guarantees of the performance of the QCCP and, as a result, does not incur any funding risk.

(2) Despite any other provision of this Part, where this Article applies institutions may exclude all amounts included in paragraph (1) from the calculation of the amount of required stable funding and available stable funding in accordance with Chapters 3 to 8 of Title 4. If all

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

amounts are not excluded the institution must calculate the amount of required stable funding and available stable funding in accordance with Title 4.

(3) Where providing derivative client clearing services in its capacity as a clearing member of a QCCP the institution receives initial margin collateral from clients that is not included in paragraph (1)(a)–

(a) collateral assets accounted for on the balance sheet of the institution are subject to a required stable funding factor in accordance with Chapter 4 or Chapter 7 of Title 4; and

(b) associated liabilities are subject to an available stable funding factor in accordance with Chapter 3 or Chapter 6 of Title 4.

Netting of secured lending transactions and capital market-driven transactions.

428E. Assets and liabilities resulting from securities financing transactions with a single counterparty must be calculated on a net basis, if those assets and liabilities comply with the netting conditions set out in Article 429B(4).

Interdependent assets and liabilities.

428F.(1) Subject to the prior approval of the GFSC, an institution may treat an asset and a liability as interdependent where all the following conditions are met–

(a) the institution acts solely as a pass-through unit to channel the funding from the liability into the corresponding interdependent asset;

(b) the individual interdependent assets and liabilities are clearly identifiable and have the same principal amount;

(c) the asset and interdependent liability have matched maturities;

(d) the interdependent liability has been requested pursuant to a legal, regulatory or contractual commitment and is not used to fund other assets;

(e) the principal payment flows from the asset are not used for other purposes than repaying the interdependent liability;

(f) the counterparties for each pair of interdependent assets and liabilities are not the same.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(2) This paragraph applies to an institution's unencumbered physical stock of precious metals and customer deposit accounts in precious metals where all the following conditions are met–

(a) unencumbered physical stock of each precious metal is used to cover customer deposit accounts in the same precious metal;

(b) the institution is not exposed to liquidity or market risk resulting from either the sale of precious metals by the customer or the physical settlement of customer transactions in precious metals; and

(c) the precious metals assets and liabilities are on the balance sheet of the institution.

(3) For the purpose of paragraph (2)–

(a) precious metals means gold, silver, platinum or palladium;

(b) the interdependent asset and liability treatment must only be available to the extent that the institution's unencumbered physical stock of each precious metal is matched by customer deposits of the same precious metal. Any excess physical stock or customer deposits in a precious metal must not be treated as an interdependent asset or liability for the purpose of paragraph (1);

(c) an institution's precious metal accounts at any other institution must not be considered a part of the institution's physical stock of precious metals.

428G. [Not used]

Preferential treatment within a group.

428H. By way of derogation from Chapters 3 and 4, the GFSC may authorise institutions on a case-by-case basis to apply a higher available stable funding factor or a lower required stable funding factor to assets, liabilities and committed credit or liquidity facilities, if all the following conditions are met–

(a) the counterparty is one of the following–

(i) the parent or a subsidiary of the institution;

(ii) another subsidiary of the same parent;

(iii) an undertaking that is related to the institution by a common management relationship;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(b) there are reasons to expect that the liability or committed credit or liquidity facility received by the institution constitutes a more stable source of funding, or that the asset or committed credit or liquidity facility granted by the institution requires less stable funding over the one-year horizon of the net stable funding ratio than the same liability, asset or committed credit or liquidity facility received or granted by other counterparties;

(c) the counterparty applies a required stable funding factor that is equal to or higher than the higher available stable funding factor or applies an available stable funding factor that is equal to or lower than the lower required stable funding factor;

(d) the institution and the counterparty are established in Gibraltar.

CHAPTER 3
AVAILABLE STABLE FUNDING

General provisions

Calculation of the amount of available stable funding.

428I. Unless otherwise specified in this Chapter, the amount of available stable funding must be calculated by multiplying the accounting value of various categories or types of liabilities and own funds by the available stable funding factors to be applied under Articles 428K to 428O. The total amount of available stable funding must be the sum of the weighted amounts of liabilities and own funds.

Bonds and other debt securities that are issued by the institution, sold exclusively in the retail market, and held in a retail account, may be treated as belonging to the appropriate retail deposit category. Limitations must be in place, such that those instruments cannot be bought and held by parties other than retail customers.

Residual maturity of a liability or of own funds.

428J.(1) Unless otherwise specified in this Chapter, institutions must take into account the residual contractual maturity of their liabilities and own funds to determine the available stable funding factors to be applied under Articles 428K to 428O.

(2) Institutions must take into account existing options in determining the residual maturity of a liability or of own funds. They must do so on the assumption that the counterparty will redeem call options at the earliest possible date. For options exercisable at the discretion of the

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

institution, the institution and the GFSC must take into account reputational factors that may limit an institution's ability not to exercise the option, in particular market expectations that institutions should redeem certain liabilities before their maturity.

(3) Institutions must treat deposits with fixed notice periods in accordance with their notice period, and must treat term deposits in accordance with their residual maturity. By way of derogation from paragraph (2), institutions must not take into account options for early withdrawals where the depositor has to pay a material penalty for early withdrawals which occur in less than one year, such penalty being laid down in Part 4 of Schedule 4, to determine the residual maturity of term retail deposits.

(4) In order to determine the available stable funding factors to be applied under Articles 428K to 428O, institutions must treat any portion of liabilities having a residual maturity of one year or more that matures in less than six months and any portion of such liabilities that matures between six months and less than one year as having a residual maturity of less than six months and between six months and less than one year, respectively.

Available stable funding factors

0% available stable funding factor.

428K.(1) Unless otherwise specified in Articles 428L to 428O, all liabilities without a stated maturity, including short positions and open maturity positions, must be subject to a 0% available stable funding factor, with the exception of the following–

(a) deferred tax liabilities, which are treated in accordance with the nearest possible date on which such liabilities could be realised;

(b) minority interests, which are treated in accordance with the term of the instrument.

(2) Deferred tax liabilities and minority interests as referred to in paragraph (1) are subject to one of the following factors–

(a) 0%, where the effective residual maturity of the deferred tax liability or minority interest is less than six months;

(b) 50%, where the effective residual maturity of the deferred tax liability or minority interest is a minimum of six months but less than one year;

(c) 100%, where the effective residual maturity of the deferred tax liability or minority interest is one year or more.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(3) The following liabilities and capital items or instruments are subject to a 0% available stable funding factor–

(a) trade date payables arising from purchases of financial instruments, of foreign currencies and of commodities, that are expected to settle within the standard settlement cycle or period that is customary for the relevant exchange or type of transactions, or that have failed to settle but are nonetheless expected to settle;

(b) liabilities that are categorised as being interdependent with assets in accordance with Article 428F;

(c) liabilities with a residual maturity of less than six months provided by–

(i) the central bank;

(ii) the central bank of a third country;

(iii) financial customers;

(d) any other liabilities and capital items or instruments not referred to in Articles 428L to 428O.

(4) Institutions must apply a 0% available stable funding factor to the absolute value of the difference, if negative, between the sum of fair values across all netting sets with positive fair value and the sum of fair values across all netting sets with negative fair value calculated in accordance with Article 428D.

The following rules must apply to the calculation referred to in the first sub-paragraph–

(a) variation margin received by institutions from their counterparties must be deducted from the fair value of a netting set with positive fair value where the collateral received as variation margin qualifies as a level 1 asset under Part 4 of Schedule 4, excluding extremely high quality covered bonds specified in that Regulation, and where institutions are legally entitled and operationally able to reuse that collateral;

(b) all variation margin posted by institutions with their counterparties must be deducted from the fair value of a netting set with negative fair value.

50% available stable funding factor.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

428L. The following liabilities and capital items or instruments are subject to a 50% available stable funding factor–

(a) deposits received that fulfil the criteria for operational deposits set out Part 4 of Schedule 4;

(b) liabilities with a residual maturity of less than one year provided by–

(i) the government of Gibraltar or the central government of a third country;

(ii) regional governments or local authorities of a third country;

(iii) public sector entities in Gibraltar or a third country;

(iv) multilateral development banks referred to in Article 117(2) and international organisations referred to in Article 118;

(v) non-financial corporate customers;

(vi) credit unions authorised by the GFSC, personal investment companies and clients that are deposit brokers to the extent that those liabilities do not fall under sub-paragraph (a);

(c) liabilities with a residual contractual maturity of a minimum of six months but less than one year that are provided by–

(i) the central bank;

(ii) the central bank of a third country;

(iii) financial customers;

(d) any other liabilities and capital items or instruments with a residual maturity of a minimum of six months but less than one year not referred to in Articles 428M, 428N and 428O.

90% available stable funding factor.

428M. Sight retail deposits, retail deposits with a fixed notice period of less than one year and term retail deposits having a residual maturity of less than one year that fulfil the relevant criteria for other retail deposits set out in Part 4 of Schedule 4are subject to a 90% available stable funding factor.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

95% available stable funding factor.

428N. Sight retail deposits, retail deposits with a fixed notice period of less than one year and term retail deposits having a residual maturity of less than one year that fulfil the relevant criteria for stable retail deposits set out in Part 4 of Schedule 4are subject to a 95% available stable funding factor.

100% available stable funding factor.

428O. The following liabilities and capital items and instruments are subject to a 100% available stable funding factor–

(a) the Common Equity Tier 1 items of the institution before the adjustments required pursuant to Articles 32 to 35, the deductions pursuant to Article 36 and the application of the exemptions and alternatives laid down in Articles 48, 49 and 79;

(b) the Additional Tier 1 items of the institution before the deduction of the items referred to in Article 56 and before Article 79 has been applied thereto, excluding any instruments with explicit or embedded options that, if exercised, would reduce the effective residual maturity to less than one year;

(c) the Tier 2 items of the institution before the deductions referred to in Article 66 and before the application of Article 79, having a residual maturity of one year or more, excluding any instruments with explicit or embedded options that, if exercised, would reduce the effective residual maturity to less than one year;

(d) any other capital instruments of the institution with a residual maturity of one year or more, excluding any instruments with explicit or embedded options that, if exercised, would reduce the effective residual maturity to less than one year;

(e) any other secured and unsecured borrowings and liabilities with a residual maturity of one year or more, including term deposits, unless otherwise specified in Articles 428K to 428N.

CHAPTER 4
REQUIRED STABLE FUNDING

General provisions

Calculation of the amount of required stable funding.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

428P.(1) Unless otherwise specified in this Chapter, the amount of required stable funding must be calculated by multiplying the accounting value of various categories or types of assets and off-balance-sheet items by the required stable funding factors to be applied in accordance with Articles 428R to 428AH. The total amount of required stable funding must be the sum of the weighted amounts of assets and off-balance-sheet items.

(2) Assets which institutions have borrowed or otherwise acquired in securities financing transactions must be subject to the required stable funding factors to be applied under 428R to 428AH where those assets are accounted for on the balance sheet of the institution or where the institution is exposed to all or substantially all of the economic risk and reward in respect of those assets. Otherwise, such assets must be excluded from the calculation of the amount of required stable funding.

(3) Assets that institutions have lent or otherwise disposed of in securities financing transactions which the institution keeps on balance sheet or in respect of which the institution retains exposure to all or substantially all of the economic risk and reward, must be considered as encumbered assets for the purposes of this Chapter and are subject to the required stable funding factors to be applied under 428R to 428AH, even where the assets do not remain on the balance sheet of the institution. Otherwise, such assets must be excluded from the calculation of the amount of required stable funding.

(4) Assets that are encumbered for a residual maturity of six months or longer must be assigned either the required stable funding factor that would be applied under 428R to 428AH to those assets if they were held unencumbered or the required stable funding factor that is otherwise applicable to those encumbered assets, whichever factor is higher. The same must apply where the residual maturity of the encumbered assets is shorter than the residual maturity of the transaction that is the source of encumbrance.

Assets that have less than six months remaining in the encumbrance period are subject to the required stable funding factors to be applied under 428R to 428AH to the same assets if they were held unencumbered.

(5) Where an institution reuses or repledges an asset that was borrowed, including in securities financing transactions, and that asset is accounted for off-balance-sheet, the transaction in relation to which that asset has been borrowed must be treated as encumbered, if the transaction cannot mature without the institution returning the asset borrowed.

(6) The following assets must be considered to be unencumbered–

(a) assets included in a pool which are available for immediate use as collateral to obtain additional funding under committed or, where the pool is operated by a central bank, uncommitted but not yet funded, credit lines that are available to the

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

institution; those assets must include assets placed by a credit institution with a central institution in a cooperative network or institutional protection scheme; institutions must assume that assets in the pool are encumbered in order of increasing liquidity on the basis of the liquidity classification under Part 4 of Schedule 4, starting with assets ineligible for the liquidity buffer;

(b) assets that the institution has received as collateral for credit risk mitigation purposes in secured lending, secured funding or collateral exchange transactions and that the institution may dispose of;

(c) assets attached as non-mandatory over-collateralisation to a covered bond issuance.

(7) In order to avoid any double counting, institutions must exclude assets that are associated with collateral that is recognised as variation margin posted in accordance with Article 428K(4)(b) and 428AH(2), recognised as initial margin posted, or recognised as a contribution to the default fund of a CCP in accordance with Article 428AG(a) and (b) from other parts of calculation of the amount of required stable funding in accordance with this Chapter. This paragraph does not apply to collateral assets associated with excess variation margin posted and not already recognised in Article 428K(4)(b) or Article 428AH(2), which institutions must take into account in other parts of the calculation of the amount of required stable funding in accordance with this Chapter.

(8) Institutions must include foreign currencies and commodities for which a purchase order has been executed in the calculation of the amount of required stable funding financial instruments. They must exclude financial instruments, foreign currencies and commodities for which a sale order has been executed from the calculation of the amount of required stable funding, if those transactions are not reflected as derivatives or secured funding transactions on the institutions' balance sheet and that those transactions are to be reflected on the institutions' balance sheet when settled.

(9) Institutions must apply appropriate stable funding factors to off-balance-sheet exposures that are not referred to in this Chapter to ensure that they hold an appropriate amount of available stable funding for the portion of those exposures that are expected to require funding over the one-year horizon of the net stable funding ratio. When considering those factors, institutions must, in particular, take into account the material reputational damage to the institution that could result from not providing that funding.

Residual maturity of an asset.

428Q.(1) Unless otherwise specified in this Chapter, institutions must take into account the residual contractual maturity of their assets and off-balance-sheet transactions when

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

determining the required stable funding factors to be applied to their assets and off-balance-sheet items under 428R to 428AH.

(2) Institutions must treat assets that have been segregated in accordance with Article 11(3) of EMIR in accordance with the underlying exposure of those assets. Institutions must, however, subject those assets to higher required stable funding factors, depending on the term of encumbrance to be determined by the competent authorities, who must consider whether the institution is able to freely dispose of or exchange such assets and must consider the term of the liabilities to the institutions' customers to whom that segregation requirement relates.

(3) When calculating the residual maturity of an asset, institutions must take options into account, based on the assumption that the issuer or counterparty will exercise any option to extend the maturity of an asset. For options that are exercisable at the discretion of the institution, the institution must take into account reputational factors that may limit the institution's ability not to exercise the option, in particular markets' and clients' expectations that the institution should extend the maturity of certain assets at their maturity date.

(4) In order to determine the required stable funding factors to be applied in accordance with 428R to 428AH, for amortising loans with a residual contractual maturity of one year or more, any portion that matures in less than six months and any portion that matures between six months and less than one year must be treated as having a residual maturity of less than six months and between six months and less than one year, respectively.

Required stable funding factors

0% required stable funding factor.

428R.(1) The following assets are subject to a 0% required stable funding factor–

(a) unencumbered assets that are eligible as level 1 high quality liquid assets under, excluding extremely high quality covered bonds specified in that Regulation, regardless of whether they comply with the operational requirements as set out in that Regulation;

(b) unencumbered shares or units in CIUs that are eligible for a 0% haircut for the calculation of the liquidity coverage ratio under Part 4 of Schedule 4, regardless of whether they comply with the operational requirements and with the requirements on the composition of the liquidity buffer set out in that Regulation;

(c) all reserves held by the institution in the central bank or the central bank of a third country, including required reserves and excess reserves;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(d) all claims on the central bank or the central bank of a third country that have a residual maturity of less than six months;

(e) trade date receivables arising from sales of financial instruments, foreign currencies or commodities that are expected to settle within the standard settlement cycle or period that is customary for the relevant exchange or type of transaction, or that have failed to settle but are nonetheless expected to settle;

(f) assets that are categorised as being interdependent with liabilities in accordance with Article 428F;

(g) monies due from securities financing transactions with financial customers, where those transactions have a residual maturity of less than six months, where those monies due are collateralised by assets that qualify as level 1 assets under Part 4 of Schedule 4, excluding extremely high quality covered bonds specified therein, and where the institution would be legally entitled and operationally able to reuse those assets for the duration of the transaction.

Institutions must take the monies due referred to in sub-paragraph (g) into account on a net basis where Article 428E applies.

(2) By way of derogation from paragraph (1)(c), institutions must apply a higher required stable funding factor to required reserves which must be–

(a) the required stable funding factor for required reserves that is prescribed by the law of the third country in which the relevant central bank is located; or

(b) if there is no law of that third country prescribing the required stable funding for required reserves, an appropriate required stable funding factor, taking into account, in particular, the extent to which reserve requirements exist over a one-year horizon and therefore require associated stable funding.

2.5% required stable funding factor.

428RA. Trade finance off-balance sheet related products as referred to in Schedule 1 with a residual maturity of less than one year are subject to a 2.5% required stable funding factor.

5% required stable funding factor.

428S.(1) The following assets and off-balance-sheet items are subject to a 5% required stable funding factor–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) unencumbered shares or units in CIUs that are eligible for a 5% haircut for the calculation of the liquidity coverage ratio in accordance with Part 4 of Schedule 4, regardless of whether they comply with the operational requirements and with the requirements on the composition of the liquidity buffer as set out in that Regulation;

(b) monies due from securities financing transactions with financial customers, where those transactions have a residual maturity of less than six months, other than those referred to in Article 428R(1)(g);

(c) the undrawn portion of committed credit and liquidity facilities under Part 4 of Schedule 4;

(d) trade finance off-balance-sheet related products as referred to in Schedule 1 with a residual maturity of less than six months.

Institutions must take the monies due referred to in sub-paragraph (b) into account on a net basis where Article 428E applies.

(2) For all netting sets of derivative contracts, institutions must apply a 5% required stable funding factor to the absolute fair value of those netting sets of derivative contracts, gross of any collateral posted, where those netting sets have a negative fair value. For the purposes of this paragraph, institutions must determine the fair value as gross of any collateral posted or settlement payments and receipts related to market valuation changes of such contracts.

7% required stable funding factor.

428T. Unencumbered assets that are eligible as level 1 extremely high quality covered bonds under Part 4 of Schedule 4 are subject to a 7% required stable funding factor, regardless of whether they comply with the operational requirements and with the requirements on the composition of the liquidity buffer as set out in that Regulation.

10% required stable funding factor.

428U. [Not used]

428V. Monies due from transactions with financial customers that have a residual maturity of less than six months other than those referred to in Articles 428R(1)(g) and 428S(1)(b) are subject to a 10% required stable funding factor.

12% required stable funding factor.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

428W. Unencumbered shares or units in CIUs that are eligible for a 12% haircut for the calculation of the liquidity coverage ratio in accordance with Part 4 of Schedule 4are subject to a 12% required stable funding factor, regardless of whether they comply with the operational requirements and with the requirements on the composition of the liquidity buffer as set out in that Regulation.

15% required stable funding factor.

428X. Unencumbered assets that are eligible as level 2A assets under Part 4 of Schedule 4are subject to a 15% required stable funding factor, regardless of whether they comply with the operational requirements and with the requirements on the composition of the liquidity buffer as set out in that Regulation.

20% required stable funding factor.

428Y. Unencumbered shares or units in CIUs that are eligible for a 20% haircut for the calculation of the liquidity coverage ratio in accordance with Part 4 of Schedule 4are subject to a 20% required stable funding factor, regardless of whether they comply with the operational requirements and with the requirements on the composition of the liquidity buffer as set out in that Regulation.

25% required stable funding factor.

428Z. Unencumbered level 2B securitisations under Part 4 of Schedule 4are subject to a 25% required stable funding factor, regardless of whether they comply with the operational requirements and with the requirements on the composition of the liquidity buffer as set out in that Regulation.

30% required stable funding factor.

428AA. The following assets are subject to a 30% required stable funding factor–

(a) unencumbered high quality covered bonds under Part 4 of Schedule 4, regardless of whether they comply with the operational requirements and with the requirements on the composition of the liquidity buffer as set out in that Regulation;

(b) unencumbered shares or units in CIUs that are eligible for a 30% haircut for the calculation of the liquidity coverage ratio in accordance with Part 4 of Schedule 4, regardless of whether they comply with the operational requirements and with the requirements on the composition of the liquidity buffer as set out in that Regulation;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(c) trade finance on-balance sheet related products with non-financial customers with a residual maturity of less than six months.

35% required stable funding factor.

428AB. The following assets are subject to a 35% required stable funding factor–

(a) unencumbered level 2B securitisations under Part 4 of Schedule 4, regardless of whether they comply with the operational requirements and with the requirements on the composition of the liquidity buffer as set out in that Regulation;

(b) unencumbered shares or units in CIUs that are eligible for a 35% haircut for the calculation of the liquidity coverage ratio under Part 4 of Schedule 4, regardless of whether they comply with the operational requirements and with the requirements on the composition of the liquidity buffer as set out in that Regulation.

40% required stable funding factor.

428AC. Unencumbered shares or units in CIUs that are eligible for a 40% haircut for the calculation of the liquidity coverage ratio under Part 4 of Schedule 4are subject to a 40% required stable funding factor, regardless of whether they comply with the operational requirements and with the requirements on the composition of the liquidity buffer as set out in that Regulation.

50% required stable funding factor.

428AD. The following assets are subject to a 50% required stable funding factor–

(a) unencumbered assets that are eligible as level 2B assets under Part 4 of Schedule 4, excluding level 2B securitisations and high quality covered bonds pursuant to that Regulation, regardless of whether they comply with the operational requirements and with the requirements on the composition of the liquidity buffer as set out in that Regulation;

(b) deposits held by the institution in another financial institution that fulfil the criteria for operational deposits as set out in Part 4 of Schedule 4;

(c) monies due from transactions with a residual maturity of less than one year with–

(i) the government of Gibraltar or the central government of a third country;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(ii) regional governments or local authorities in a third country;

(iii) public sector entities in Gibraltar or a third country;

(iv) multilateral development banks referred to in Article 117(2) and international organisations referred to in Article 118;

(v) non-financial corporates, retail customers and SMEs;

(vi) credit unions authorised by the GFSC, personal investment companies and clients that are deposit brokers to the extent that those assets do not fall under sub-paragraph (b);

(d) monies due from transactions with a residual maturity of at least six months but less than one year with–

(i) the central bank or the central bank of a third country;

(ii) financial customers;

(e) trade finance on-balance-sheet related products with a residual maturity of at least six months but less than one year;

(f) assets encumbered for a residual maturity of at least six months but less than one year, except where those assets would be assigned a higher required stable funding factor in accordance with Articles 428AE to 428AH if they were held unencumbered, in which case the higher required stable funding factor that would apply to those assets if they were held unencumbered must apply;

(g) any other assets with a residual maturity of less than one year, unless otherwise specified in Articles 428R to 428AC.

55% required stable funding factor.

428AE. Unencumbered shares or units in CIUs that are eligible for a 55% haircut for the calculation of the liquidity coverage ratio in accordance with Part 4 of Schedule 4are subject to a 55% required stable funding factor, regardless of whether they comply with the operational requirements and with the requirements on the composition of the liquidity buffer as set out in that Regulation.

65% required stable funding factor.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

428AF.(1) The following assets are subject to a 65% required stable funding factor–

(a) unencumbered loans secured by mortgages on residential property with a residual maturity of one year or more, if those loans are assigned a risk weight of 35% or less in accordance with Chapter 2 of Title 2 of Part 3;

(b) unencumbered loans with a residual maturity of one year or more, excluding loans to financial customers and loans referred to in Articles 428R to 428AD, if those loans are assigned a risk weight of 35% or less in accordance with Chapter 2 of Title 2 of Part 3.

(2) Institutions must apply a 65% required stable funding factor to the most senior tranche or, if the institution has retained all tranches, all tranches of unencumbered securitisations–

(a) with a residual maturity of one year or more;

(b) where the underlying exposures were originated by–

(i) the institution;

(ii) a subsidiary of the institution; or

(iii) a third party provided the exposures were purchased by any of the entities in paragraph (2)(b)(i) to (ii) prior to the securitisation; and

(c) whose underlying exposures would be subject to paragraph (1)(a) had the underlying exposures not been securitised.

85% required stable funding factor.

428AG. The following assets and off-balance-sheet items are subject to an 85% required stable funding factor–

(a) any assets and off-balance-sheet items, including cash, posted as initial margin for derivative contracts, unless those assets would be assigned a higher required stable funding factor in accordance with Article 428AH if held unencumbered, in which case the higher required stable funding factor that would apply to those assets if they were held unencumbered must apply;

(b) any assets and off-balance-sheet items, including cash, posted as contribution to the default fund of a CCP, unless those would be assigned a higher required stable funding factor in accordance with Article 428AH if held unencumbered, in which

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

case the higher required stable funding factor to be applied to the unencumbered asset must apply;

(c) unencumbered loans with a residual maturity of one year or more, excluding loans to financial customers and loans referred to in Articles 428R to 428AF, which are not past due for more than 90 days and which are assigned a risk weight of more than 35% in accordance with Chapter 2 of Title 2 of Part 3;

(d) trade finance on-balance-sheet related products, with a residual maturity of one year or more;

(e) unencumbered securities with a residual maturity of one year or more that are not in default in accordance with Article 178 and that are not eligible as liquid assets under Part 4 of Schedule 4;

(f) unencumbered exchange-traded equities that are not eligible as level 2B assets under Part 4 of Schedule 4;

(g) physically traded commodities, including gold but excluding commodity derivatives;

(h) assets encumbered for a residual maturity of one year or more in a cover pool funded by CRR covered bonds or covered bonds which meet the eligibility requirements for the treatment as set out in Article 129(4) or (5).

100% required stable funding factor.

428AH.(1) The following assets are subject to a 100% required stable funding factor–

(a) unless otherwise specified in this Chapter, any assets encumbered for a residual maturity of one year or more;

(b) any assets other than those referred to in Articles 428R to 428AG, including loans to financial customers having a residual contractual maturity of one year or more, non-performing exposures, items deducted from own funds, fixed assets, non-exchange-traded equities, retained interest, insurance assets, defaulted securities.

(2) Institutions must apply a 100% required stable funding factor to the difference, if positive, between the sum of fair values across all netting sets with positive fair value and the sum of fair values across all netting sets with negative fair value calculated in accordance with Article 428D.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

The following rules must apply to the calculation referred to in the first sub-paragraph–

(a) variation margin received by institutions from their counterparties must be deducted from the fair value of a netting set with positive fair value where the collateral received as variation margin qualifies as a level 1 asset under Part 4 of Schedule 4, excluding extremely high quality covered bonds specified in that Regulation, and where institutions are legally entitled and operationally able to reuse that collateral;

(b) all variation margin posted by institutions with their counterparties must be deducted from the fair value of a netting set with negative fair value.

CHAPTER 5
DEROGATION FOR SMALL AND NON-COMPLEX INSTITUTIONS

Derogation for small and non-complex institutions.

428AI. By way of derogation from Chapters 3 and 4, small and non-complex institutions may choose, with GFSC approval, to calculate the ratio between an institution's available stable funding as referred to in Chapter 6, and the institution's required stable funding as referred to in Chapter 7, expressed as a percentage.

The GFSC may require a small and non-complex institution to comply with the net stable funding requirement based on an institution's available stable funding as referred to in Chapter 3 and the required stable funding as referred to in Chapter 4 where it considers that the simplified methodology is not adequate to capture the funding risks of that institution.

CHAPTER 6
AVAILABLE STABLE FUNDING FOR THE SIMPLIFIED CALCULATION OF THE NET STABLE FUNDING RATIO

General provisions

Simplified calculation of the amount of available stable funding.

428AJ.(1) Unless otherwise specified in this Chapter, the amount of available stable funding must be calculated by multiplying the accounting value of various categories or types of liabilities and own funds by the available stable funding factors to be applied under Articles 428AL to 428AP. The total amount of available stable funding must be the sum of the weighted amounts of liabilities and own funds.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(2) Bonds and other debt securities that are issued by the institution, sold exclusively in the retail market, and held in a retail account, may be treated as belonging to the appropriate retail deposit category. Limitations must be in place, such that those instruments cannot be bought and held by parties other than retail customers.

Residual maturity of a liability or own funds.

428AK.(1) Unless otherwise specified in this Chapter, institutions must take into account the residual contractual maturity of their liabilities and own funds to determine the available stable funding factors to be applied under Articles 428AL to 428AP.

(2) Institutions must take into account existing options in determining the residual maturity of a liability or of own funds. They must do so on the assumption that the counterparty will redeem call options at the earliest possible date. For options exercisable at the discretion of the institution, the institution and the GFSC must take into account reputational factors that may limit an institution's ability not to exercise the option, in particular market expectations that institutions should redeem certain liabilities before their maturity.

(3) Institutions must treat deposits with fixed notice periods in accordance with their notice period, and must treat term deposits in accordance with their residual maturity. By way of derogation from paragraph (2), institutions must not take into account options for early withdrawals where the depositor has to pay a material penalty for early withdrawals which occur in less than one year, such penalty being laid down in Part 4 of Schedule 4, to determine the residual maturity of term retail deposits.

(4) In order to determine the available stable funding factors to be applied under Articles 428AL to 428AP, for liabilities with a residual contractual maturity of one year or more, any portion that matures in less than six months and any portion that matures between six months and less than one year, must be treated as having a residual maturity of less than six months and between six months and less than one year, respectively.

Available stable funding factors

0% available stable funding factor.

428AL.(1) Unless otherwise specified in Articles 428AL to 328AP, all liabilities without a stated maturity, including short positions and open maturity positions, are subject to a 0% available stable funding factor, with the exception of the following–

(a) deferred tax liabilities, which are treated in accordance with the nearest possible date on which such liabilities could be realised;

(b) minority interests, which are treated in accordance with the term of the instrument concerned.

(2) Deferred tax liabilities and minority interests as referred to in paragraph (1) are subject to one of the following factors–

(a) 0%, where the effective residual maturity of the deferred tax liability or minority interest is less than one year;

(b) 100%, where the effective residual maturity of the deferred tax liability or minority interest is one year or more.

(3) The following liabilities and capital items or instruments are subject to a 0% available stable funding factor–

(a) trade date payables arising from purchases of financial instruments, of foreign currencies and of commodities, that are expected to settle within the standard settlement cycle or period that is customary for the relevant exchange or type of transaction, or that have failed to settle but are nonetheless expected to settle;

(b) liabilities that are categorised as being interdependent with assets in accordance with Article 428F;

(c) liabilities with a residual maturity of less than one year provided by–

(i) the central bank or the central bank of a third country;

(ii) financial customers;

(d) any other liabilities and capital items or instruments not referred to in this Article and Articles 428AM to 428AP.

(4) Institutions must apply a 0% available stable funding factor to the absolute value of the difference, if negative, between the sum of fair values across all netting sets with positive fair value and the sum of fair values across all netting sets with negative fair value calculated in accordance with Article 428D.

The following rules must apply to the calculation referred to in the first sub-paragraph–

(a) variation margin received by institutions from their counterparties must be deducted from the fair value of a netting set with positive fair value where the collateral received as variation margin qualifies as a level 1 asset under Part 4 of

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Schedule 4, excluding extremely high quality covered bonds specified in that Regulation, and where institutions are legally entitled and operationally able to reuse that collateral;

(b) all variation margin posted by institutions with their counterparties must be deducted from the fair value of a netting set with negative fair value.

50% available stable funding factor.

428AM. The following liabilities and capital items or instruments are subject to a 50% available stable funding factor–

(a) deposits received that fulfil the criteria for operational deposits set out in Part 4 of Schedule 4;

(b) liabilities with a residual maturity of less than one year provided by–

(i) the government of Gibraltar or the central government of a third country;

(ii) regional governments or local authorities in a third country;

(iii) public sector entities in Gibraltar or a third country;

(iv) multilateral development banks referred to in Article 117(2) and international organisations referred to in Article 118;

(v) non-financial corporate customers;

(vi) credit unions authorised by the GFSC, personal investment companies and clients that are deposit brokers, with the exception of deposits received, that fulfil the criteria for operational deposits as set out in Part 4 of Schedule 4.

90% available stable funding factor.

428AN. Sight retail deposits, retail deposits with a fixed notice period of less than one year and term retail deposits having a residual maturity of less than one year that fulfil the relevant criteria for other retail deposits set out in Part 4 of Schedule 4are subject to a 90% available stable funding factor.

95% available stable funding factor.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

428AO. Sight retail deposits, retail deposits with a fixed notice period of less than one year and term retail deposits having a residual maturity of less than one year that fulfil the relevant criteria for stable retail deposits set out in Part 4 of Schedule 4are subject to a 95% available stable funding factor.

100% available stable funding factor.

428AP. The following liabilities and capital items and instruments are subject to a 100% available stable funding factor–

(a) the Common Equity Tier 1 items of the institution before the adjustments required pursuant to Articles 32 to 35, the deductions pursuant to Article 36 and the application of the exemptions and alternatives laid down in Articles 48, 49 and 79;

(b) the Additional Tier 1 items of the institution before the deduction of the items referred to in Article 56 and before Article 79 has been applied, excluding any instruments with explicit or embedded options that, if exercised, would reduce the effective residual maturity to less than one year;

(c) the Tier 2 items of the institution before the deductions referred to in Article 66 and before the application of Article 79, having a residual maturity of one year or more, excluding any instruments with explicit or embedded options that, if exercised, would reduce the effective residual maturity to less than one year;

(d) any other capital instruments of the institution with a residual maturity of one year or more, excluding any instruments with explicit or embedded options that, if exercised, would reduce the effective residual maturity to less than one year;

(e) any other secured and unsecured borrowings and liabilities with a residual maturity of one year or more, including term deposits, unless otherwise specified in Articles 428AL to 428AO.

CHAPTER 7
REQUIRED STABLE FUNDING FOR THE SIMPLIFIED CALCULATION OF THE NET STABLE FUNDING RATIO

General provisions

Simplified calculation of the amount of required stable funding.

428AQ.(1) Unless otherwise specified in this Chapter, for small and non-complex institutions the amount of required stable funding must be calculated by multiplying the accounting value

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

of various categories or types of assets and off-balance-sheet items by the required stable funding factors to be applied in accordance with Articles 428AS to 428AZ. The total amount of required stable funding must be the sum of the weighted amounts of assets and off-balance-sheet items.

(2) Assets that institutions have borrowed or otherwise acquired in securities financing transactions must be subject to the required stable funding factors to be applied under Articles 428AS to 428AZ where those assets are accounted for on the balance sheet of the institution or where the institution is exposed to all or substantially all of the economic risk and reward in respect of those assets. Otherwise, such assets must be excluded from the calculation of the amount of required stable funding.

(3) Assets that institutions have lent or otherwise disposed of in securities financing transactions which the institution keeps on balance sheet or in respect of which the institution retains exposure to all or substantially all of the economic risk and reward, must be considered as encumbered assets for the purposes of this Chapter and must be subject to required stable funding factors to be applied under Articles 428AS to 428AZ. Otherwise, such assets must be excluded from the calculation of the amount of required stable funding.

(4) Assets that are encumbered for a residual maturity of six months or longer must be assigned either the required stable funding factor that would be applied under Articles 428AS to 428AZ to those assets if they were held unencumbered or the required stable funding factor that is otherwise applicable to those encumbered assets, whichever factor is higher. The same must apply where the residual maturity of the encumbered assets is shorter than the residual maturity of the transaction that is the source of encumbrance.

Assets that have less than six months remaining in the encumbrance period are subject to the required stable funding factors to be applied under Articles 428AS to 428AZ to the same assets if they were held unencumbered.

(5) Where an institution reuses or repledges an asset that was borrowed, including in securities financing transactions, and that is accounted for off-balance-sheet, the transaction through which that asset has been borrowed is treated as encumbered to the extent that the transaction cannot mature without the institution returning the asset borrowed.

(6) The following assets must be considered to be unencumbered–

(a) assets included in a pool which are available for immediate use as collateral to obtain additional funding under committed or, where the pool is operated by a central bank, uncommitted but not yet funded credit lines available to the institution;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(b) assets that the institution has received as collateral for credit risk mitigation purposes in secured lending, secured funding or collateral exchange transactions and that the institution may dispose of;

(c) assets attached as non-mandatory over-collateralisation to a covered bond issuance.

For the purposes of sub-paragraph (a), institutions must assume that assets in the pool are encumbered in order of increasing liquidity on the basis of the liquidity classification set out in Part 4 of Schedule 4, starting with assets ineligible for the liquidity buffer.

(7) Institutions must exclude assets associated with collateral recognised as variation margin posted in accordance with Articles 428K(4)(b) and 428AH(2) or as initial margin posted or as contribution to the default fund of a CCP in accordance with Article 428AG(a) and (b) from other parts of calculation of the amount of required stable funding in accordance with this Chapter in order to avoid any double counting.

(8) Institutions must include in the calculation of the amount of required stable funding financial instruments, foreign currencies and commodities for which a purchase order has been executed. They must exclude from the calculation of the amount of required stable funding financial instruments, foreign currencies and commodities for which a sale order has been executed, if those transactions are not reflected as derivatives or secured funding transactions on the institutions' balance sheet and that those transactions are to be reflected on the institutions' balance sheet when settled.

(9) The GFSC may determine the required stable funding factors to be applied to off-balance-sheet exposures that are not referred to in this Chapter to ensure that institutions hold an appropriate amount of available stable funding for the portion of those exposures that are expected to require funding over the one-year horizon of the net stable funding ratio. To determine those factors, The GFSC must, in particular, take into account the material reputational damage to the institution that could result from not providing that funding.

Residual maturity of an asset.

428AR.(1) Unless otherwise specified in this Chapter, institutions must take into account the residual contractual maturity of their assets and off-balance-sheet transactions when determining the required stable funding factors to be applied to their assets and off-balance-sheet items under Articles 428AS to 428AZ.

(2) Institutions must treat assets that have been segregated in accordance with Article 11(3) of EMIR in accordance with the underlying exposure of those assets. Institutions must, however, subject those assets to higher required stable funding factors, depending on the term

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

of encumbrance to be determined by the GFSC, who must consider whether the institution is able to freely dispose of or exchange such assets and must consider the term of the liabilities to the institutions' customers to whom that segregation requirement relates.

(3) When calculating the residual maturity of an asset, institutions must take options into account, based on the assumption that the issuer or counterparty will exercise any option to extend the maturity of an asset. For options that are exercisable at the discretion of the institution, the institution and competent authorities must take into account reputational factors that may limit the institution's ability not to exercise the option, in particular markets' and clients' expectations that the institution should extend the maturity of certain assets at their maturity date.

(4) In order to determine the required stable funding factors to be applied in accordance with Articles 428AS to 428AZ, for amortising loans with a residual contractual maturity of one year or more, the portions that mature in less than six months and between six months and less than one year must be treated as having a residual maturity of less than six months and between six months and less than one year respectively.

Required stable funding factors

0% required stable funding factor.

428AS.(1) The following assets are subject to a 0% required stable funding factor–

(a) unencumbered assets that are eligible as level 1 high quality liquid assets under Part 4 of Schedule 4, excluding extremely high quality covered bonds specified in that Regulation, regardless of whether they comply with the operational requirements as set out in that Regulation;

(b) all reserves held by the institution in the central bank or the central bank of a third country, including required reserves and excess reserves;

(c) all claims on the central bank or the central bank of a third country that have a residual maturity of less than six months;

(d) assets that are categorised as being interdependent with liabilities in accordance with Article 428F.

(2) By way of derogation from paragraph (1)(b), institutions must apply a higher required stable funding factor to required reserves which must be–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) the required stable funding factor for required reserves that is prescribed by the law of the third country in which the relevant central bank is located; or

(b) if there is no law of that third country prescribing the required stable funding for required reserves, an appropriate required stable funding factor, taking into account, in particular, the extent to which reserve requirements exist over a one-year horizon and therefore require associated stable funding.

5% required stable funding factor.

428AT.(1) The undrawn portion of committed credit and liquidity facilities specified in Part 4 of Schedule 4 are subject to a 5% required stable funding factor.

(2) For all netting sets of derivative contracts, institutions must apply a 5% required stable funding factor to the absolute fair value of those netting sets of derivative contracts, gross of any collateral posted, where those netting sets have a negative fair value. For the purposes of this paragraph, institutions must determine the fair value as gross of any collateral posted or settlement payments and receipts related to market valuation changes of such contracts.

(3) Trade finance off-balance sheet related products as referred to in Schedule 1 with a residual maturity of one year or more are subject to a 5% required stable funding factor.

10% required stable funding factor.

428AU. Unencumbered assets that are eligible as level 1 extremely high quality covered bonds under Part 4 of Schedule 4, are subject to a 10% required stable funding factor, regardless of whether they comply with the operational requirements and with the requirements on the composition of the liquidity buffer as set out in that Regulation.

20% required stable funding factor.

428AV. Unencumbered assets that are eligible as level 2A assets under Part 4 of Schedule 4, and unencumbered shares or units in CIUs pursuant to that Regulation are subject to a 20% required stable funding factor, regardless of whether they comply with the operational requirements and with the requirements on the composition of the liquidity buffer as set out in that Regulation.

50% required stable funding factor.

428AW. The following assets are subject to a 50% required stable funding factor–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) secured and unsecured loans with a residual maturity of less than one year and if they are encumbered less than one year;

(b) any other assets with a residual maturity of less than one year, unless otherwise specified in Articles 428AS to 428AV;

(c) assets encumbered for a residual maturity of at least six months but less than one year, except where those assets would be assigned a higher required stable funding factor in accordance with Articles 428AX, 428AY and 428AZ if they were held unencumbered, in which case the higher required stable funding factor that would apply to those assets if they were held unencumbered must apply.

55% required stable funding factor.

428AX. Assets that are eligible as level 2B assets under Part 4 of Schedule 4, and shares or units in CIUs under that Regulation are subject to a 55% required stable funding factor, regardless of whether they comply with the operational requirements and with the requirements on the composition of the liquidity buffer as set out in that Regulation, if they are encumbered less than one year.

65% required stable funding factor.

428AXA.(1) Unencumbered loans secured by mortgages on residential property with a residual maturity of one year or more, if those loans are assigned a risk weight of 35% or less in accordance with Chapter 2 of Title 2 of Part 3, are subject to a 65% required stable funding factor.

(2) Institutions must apply a 65% required stable funding factor to the most senior tranche or, if the institution has retained all tranches, all tranches of unencumbered securitisations–

(a) with a residual maturity of one year or more;

(b) where the underlying exposures were originated by–

(i) the institution;

(ii) a subsidiary of the institution; or

(iii) a third party provided the exposures were purchased by any of the entities in paragraph (2)(b)(i) to (ii) prior to the securitisation; and

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(c)whose underlying exposures would be subject to paragraph (1) had the underlying exposures not been securitised.

85% required stable funding factor.

428AY. The following assets and off-balance-sheet items are subject to a 85% required stable funding factor–

(a) any assets and off-balance-sheet items, including cash, posted as initial margin for derivative contracts or posted as contribution to the default fund of a CCP, unless those assets would be assigned a higher required stable funding factor in accordance with Article 428AZ if held unencumbered, in which case the higher required stable funding factor that would apply to those assets if they were held unencumbered must apply;

(b) unencumbered loans with a residual maturity of one year or more, excluding loans to financial customers, which are not past due for more than 90 days;

(c) trade finance on-balance-sheet related products, with a residual maturity of one year or more;

(d) unencumbered securities with a residual maturity of one year or more that are not in default in accordance with Article 178 and that are not eligible as liquid assets under Part 4 of Schedule 4;

(e) unencumbered exchange-traded equities that are not eligible as level 2B assets under Article 428AX;

(f) physically traded commodities, including gold but excluding commodity derivatives unless otherwise specified in Article 428F;

(g) unencumbered loans secured by mortgages on residential property with a residual maturity of one year or more, if those loans are assigned a risk weight of more than 35% in accordance with Chapter 2 of Title 2 of Part 3.

100% required stable funding factor.

428AZ.(1) The following assets are subject to a 100% required stable funding factor–

*(a) any assets encumbered for a residual maturity of one year or more;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(b) any assets other than those referred to in Articles 428AS to 428AY, including loans to financial customers having a residual contractual maturity of one year or more, non-performing exposures, items deducted from own funds, fixed assets, non-exchange traded equities, retained interest, insurance assets, defaulted securities.

(2) Institutions must apply a 100% required stable funding factor to the difference, if positive, between the sum of fair values across all netting sets with positive fair value and the sum of fair values across all netting sets with negative fair value calculated in accordance with Article 428D.

The following rules must apply to the calculation referred to in the first sub-paragraph–

(a) variation margin received by institutions from their counterparties must be deducted from the fair value of a netting set with positive fair value where the collateral received as variation margin qualifies as a level 1 asset under Part 4 of Schedule 4, excluding extremely high quality covered bonds specified in that Regulation, and where institutions are legally entitled and operationally able to reuse that collateral;

(b) all variation margin posted by institutions with their counterparties must be deducted from the fair value of a netting set with negative fair value.

PART 7
LEVERAGE

Calculation of the leverage ratio.

429.(1) Institutions must calculate their leverage ratio in accordance with the methodology set out in paragraphs (2), (3) and (4).

(2) The leverage ratio must be calculated as an institution's capital measure divided by that institution's total exposure measure and must be expressed as a percentage.

(3) For the purposes of paragraph (2), the capital measure must be the Tier 1 capital.

(4) For the purposes of paragraph (2), the total exposure measure must be the sum of the exposure values of–

(a) assets, excluding derivative contracts listed in Schedule 2, credit derivatives and the positions referred to in Article 429E, calculated in accordance with Article 429B(1);

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(b) derivative contracts listed in Schedule 2 and credit derivatives, including those contracts and credit derivatives that are off-balance-sheet, calculated in accordance with Articles 429C and 429D;

(c) add-ons for counterparty credit risk of securities financing transactions, including those that are off-balance-sheet, calculated in accordance with Article 429E;

(d) off-balance-sheet items, excluding derivative contracts listed in Schedule 2, credit derivatives, securities financing transactions and positions referred to in Articles 429D and 429G, calculated in accordance with Article 429F; and

(e) regular-way purchases or sales awaiting settlement, calculated in accordance with Article 429G.

Institutions must treat long settlement transactions in accordance with sub-paragraphs (a) to (d), as applicable.

Institutions may reduce the exposure values referred to in sub-paragraphs (a) and (d) by the corresponding amount of general credit risk adjustments to on- and off-balance-sheet items, respectively, subject to a floor of 0 where the credit risk adjustments have reduced the Tier 1 capital.

(5) By way of derogation from paragraph (4)(d), the following provisions must apply–

(a) a derivative instrument that is considered an off-balance-sheet item in accordance with paragraph (4)(d) but is treated as a derivative in accordance with the applicable accounting framework, is subject to the treatment set out in paragraph (4)(b);

(b) where a client of an institution acting as a clearing member enters directly into a derivative transaction with a CCP and the institution guarantees the performance of its client's trade exposures to the CCP arising from that transaction, the institution must calculate its exposure resulting from the guarantee in accordance with paragraph (4)(b), as if that institution had entered directly into the transaction with the client, including with regard to the receipt or provision of cash variation margin.

The treatment set out in sub-paragraph (b) must also apply to an institution acting as a higher-level client that guarantees the performance of its client's trade exposures.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

For the purposes of sub-paragraph (b) and of the second sub-paragraph, institutions may consider an affiliated entity as a client only where that entity is outside the regulatory scope of consolidation at the level at which the requirement set out in Article 92(3)(d) is applied.

(6) For the purposes of paragraph (4)(e) and Article 429G, "regular-way purchase or sale" means a purchase or a sale of a security under contracts for which the terms require delivery of the security within the period established generally by law or convention in the marketplace concerned.

(7) Unless otherwise expressly provided for in this Part, institutions must calculate the total exposure measure in accordance with the following principles–

(a) physical or financial collateral, guarantees or credit risk mitigation purchased must not be used to reduce the total exposure measure;

(b) assets must not be netted with liabilities.

(8) [Not used]

Exposures excluded from the total exposure measure.

429A.(A1) By way of derogation from Article 429(4), a central bank claim of an institution must be netted off against a liability, if–

(a) the central bank claim and liability are denominated in the same currency;

(b) where applicable, the date of contractual maturity of the central bank claim is the same as, or is before, the date of contractual maturity of the liability; and

(c) where the central bank claim is represented by reserves in an omnibus account, the conditions in paragraph (A2) are met.

For the purposes of sub-paragraph (b), and in relation to liabilities which are not deposits, institutions must take into account existing options in determining the residual maturity of the liability in a prudent manner. Institutions must do so on the assumption that the counterparty will redeem call options at the earliest possible date.

For options exercisable at the discretion of the institution, the institution must take into account reputational factors that may limit an institution's ability not to exercise the option, in particular market expectations that institutions should redeem certain liabilities before their maturity.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

In this paragraph "central bank claim" means an institution's exposures to a central bank that are denominated in the national currency of the central bank and represented by–

(a) banknotes and coins constituting legal currency in the jurisdiction of the central bank;

(b) reserves held by the institution at the central bank;

(c) reserves held by or on behalf of the institution in an omnibus account at the central bank; or

(d) any assets representing debt claims on the central bank with a maturity of no longer than three months.

(A2) The conditions relating to an omnibus account referred to in (A1)(c) are as follows–

(a) there are effective legal, operational, risk management and governance arrangements relating to the omnibus account;

(b) the arrangements ensure that–

(i) a participant entity's entitlement to funds in the omnibus account is discrete from any other participant entity's entitlement;

(ii) each participant entity always has access to details of such entitlement; and

(iii) the funds in the omnibus account to which a participant entity is entitled are not available to any other participant entity or any other participant entity's creditors.

(c) if a third-party holds the omnibus account on behalf of the participant entities, the arrangements ensure that the funds in the omnibus account are–

(i) segregated from any other assets held by the third-party; and

(ii) not available to any creditors of the third-party (except so far as the central bank can debit charges from the omnibus account);

(d) if the central bank where the omnibus account is held can debit charges from the omnibus account, the arrangements ensure that–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(i) each participant entity has access to details of the method of calculating its due portion of any charge levied by the central bank on the omnibus account;

(ii) the method of apportionment is not unfair or unreasonable; and

(iii) the central bank does not debit the funds in the omnibus account to which a participant entity is entitled with an amount greater than the total of–

(aa) the participant entity's due portion of the charges in respect of the omnibus account; and

(bb) if the central bank can also deduct charges relating to any other account that the participant entity holds at the central bank, the amount of any such due charges;

(e) if the omnibus account is used for the purpose of settling obligations between participant entities through a payment system, the arrangements ensure that the participant entities' balances in the payment system are always fully funded with funds held in the omnibus account;

(f) if the omnibus account is used as part of the operation of a payment system (whether for the purpose of settlement or otherwise), the payment system is subject to oversight, including through oversight of any operator of such payment system, by a regulatory body in the jurisdiction of the central bank;

(g) the requirements in Articles 7(2) and 8(2) are met in respect of the funds held by or on behalf of the firm in the omnibus account.

(1) By way of derogation from Article 429(4), an institution may exclude any of the following exposures from its total exposure measure–

(a) the amounts deducted from Common Equity Tier 1 items in accordance with Article 36(1)(d);

(b) any items, other than the liabilities, deducted in the calculation of the capital measure referred to in Article 429(3);

(c) exposures that are assigned a risk weight of 0% in accordance with Article 113(6) if the GFSC has also given approval to the institution under this article;

(d) to (f) [not used]

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(g) where the institution is a clearing member of a QCCP, the trade exposures of that institution, if they are cleared with that QCCP and meet the conditions set out in Article 306(1)(c);

(h) where the institution is a higher-level client within a multi-level client structure, the trade exposures to the clearing member or to an entity that serves as a higher-level client to that institution, if the conditions set out in Article 305(2) are met and if the institution is not obligated to reimburse its client for any losses suffered in the event of default of either the clearing member or the QCCP;

(i) fiduciary assets which meet all the following conditions–

(i) they are recognised on the institution's balance sheet by generally accepted accounting principles;

(ii) they meet the criteria for non-recognition set out in International Financial Reporting Standard (IFRS) 9, as applied in accordance with UK-adopted international accounting standards;

(iii) they meet the criteria for non-consolidation set out in IFRS 10, as applied in accordance with UK-adopted international accounting standards, where applicable;

(j) exposures that meet all the following conditions–

(i) they are exposures to a public sector entity;

(ii) they are treated in accordance with Article 116(4);

(iii) they arise from deposits that the institution is legally obliged to transfer to the public sector entity referred to in paragraph (i) for the purpose of funding general interest investments;

(k) the excess collateral deposited at tri-party agents that has not been lent out;

(l) where under the applicable accounting framework an institution recognises the variation margin paid in cash to its counterparty as a receivable asset, the receivable asset, if the conditions set out in Article 429C(3)(a) to (e) are met;

(m) the securitised exposures from traditional securitisations that meet the conditions for significant risk transfer set out in Article 244(2);

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(n) to (p) [not used]

For the purposes of sub-paragraph (m), institutions must include any retained exposure in the total exposure measure.

The GFSC may grant approval under sub-paragraph (c) only where all the conditions set out in Article 113(6)(a) to (e) are met and where the GFSC has given the approval laid down in Article 113(6).

(2) to (3) [Not used]

(4) Institutions must not exclude the trade exposures referred to paragraph (1)(g) and (h) where the condition set out in the third sub-paragraph of Article 429(5) is not met.

(5) to (7) [Not used]

Calculation of the exposure value of assets.

429B.(1) Institutions must calculate the exposure value of assets, excluding derivative contracts listed in Schedule 2, credit derivatives and the positions referred to in Article 429E in accordance with the following principles–

(a) the exposure values of assets means an exposure value as referred to in the first sentence of Article 111(1);

(b) securities financing transactions must not be netted.

(2) A cash pooling arrangement offered by an institution does not violate the condition set out in Article 429(7)(b) only where the arrangement meets both of the following conditions–

(a) the institution offering the cash pooling arrangement transfers the credit and debit balances of several individual accounts of entities of a group included in the arrangement (‘original accounts’) into a separate, single account and thereby sets the balances of the original accounts to zero;

(b) the institution carries out the actions referred to in sub-paragraph (a) on a daily basis.

For the purposes of this paragraph and paragraph (3), cash pooling arrangement means an arrangement whereby the credit or debit balances of several individual accounts are combined for the purposes of cash or liquidity management.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(3). By way of derogation from paragraph (2), a cash pooling arrangement that does not meet the condition set out in paragraph(2)(b), but meets the condition set out in sub-paragraph (a) of that paragraph, does not violate the condition set out in Article 429(7)(b), if the arrangement meets all the following conditions–

(a) the institution has a legally enforceable right to set off the balances of the original accounts through the transfer into a single account at any point in time;

(b) there are no maturity mismatches between the balances of the original accounts;

(c) the institution charges or pays interest based on the combined balance of the original accounts;

(d) the GFSC considers that the frequency by which the balances of all original accounts are transferred is adequate for the purpose of including only the combined balance of the cash pooling arrangement in the total exposure measure.

(4) By way of derogation from paragraph (1)(b), institutions may calculate the exposure value of cash receivable and cash payable under securities financing transactions with the same counterparty on a net basis only where all the following conditions are met–

(a) the 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 in the normal course of business and in the event of default, insolvency and bankruptcy;

(c) the counterparties intend to settle on a net basis or to settle simultaneously, or the transactions are subject to a settlement mechanism that results in the functional equivalent of net settlement.

(5) For the purposes of paragraph (4)(c), institutions may consider that a settlement mechanism results in the functional equivalent of net settlement only where, on the settlement date, the net result of the cash flows of the transactions under that mechanism is equal to the single net amount under net settlement and all the following conditions are met–

(a) the transactions are settled through the same settlement system or settlement systems using a common settlement infrastructure;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(b) the settlement arrangements are supported by cash or intraday credit facilities intended to ensure that the settlement of the transactions will occur by the end of the business day;

(c) any issues arising from the securities legs of the securities financing transactions do not interfere with the completion of the net settlement of the cash receivables and payables.

The condition set out in sub-paragraph (c) is met only where the failure of any securities financing transaction in the settlement mechanism may delay settlement of only the matching cash leg or may create an obligation to the settlement mechanism, supported by an associated credit facility.

Where there is a failure of the securities leg of a securities financing transaction in the settlement mechanism at the end of the window for settlement in the settlement mechanism, institutions must split out this transaction and its matching cash leg from the netting set and treat them on a gross basis.

Calculation of the exposure value of derivatives.

429C.(1) Institutions must calculate the exposure value of derivative contracts listed in Schedule 2 and of credit derivatives, including those that are off-balance-sheet, in accordance with the method set out in Article 274.

When calculating the exposure value, institutions may take into account the effects of contracts for novation and other netting agreements in accordance with Article 295. Institutions must not take into account cross-product netting, but may net within the product category as referred to in Article 272(25)(c) and credit derivatives where they are subject to a contractual cross-product netting agreement as referred to in Article 295(c).

Institutions must include in the total exposure measure sold options even where their exposure value can be set to zero in accordance with the treatment laid down in Article 274(5).

(2) Where the provision of collateral related to derivative contracts reduces the amount of assets under the applicable accounting framework, institutions must reverse that reduction.

(3) For the purposes of paragraph (1), institutions calculating the replacement cost of derivative contracts in accordance with Article 275 may recognise only collateral received in cash from their counterparties as the variation margin referred to in Article 275, where the applicable accounting framework has not already recognised the variation margin as a reduction of the exposure value and where all the following conditions are met–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) for trades not cleared through a QCCP, the cash received by the recipient counterparty is not segregated;

(b) the variation margin is calculated and exchanged at least daily based on a mark-to-market valuation of derivatives positions;

(c) the variation margin received is in a currency specified in the derivative contract, governing master netting agreement, credit support annex to the qualifying master netting agreement or as defined by any netting agreement with a QCCP;

(d) the variation margin received is the full amount that would be necessary to extinguish the mark-to-market exposure of the derivative contract subject to the threshold and minimum transfer amounts that are applicable to the counterparty;

(e) the derivative contract and the variation margin between the institution and the counterparty to that contract are covered by a single netting agreement that the institution may treat as risk-reducing in accordance with Article 295.

Where an institution provides cash collateral to a counterparty and that collateral meets the conditions set out in sub-paragraphs (a) to (e), the institution must consider that collateral as the variation margin posted with the counterparty and must include it in the calculation of the replacement cost.

For the purposes of sub-paragraph (b), an institution must be considered to have met the condition set out therein where the variation margin is exchanged on the morning of the trading day following the trading day on which the derivative contract was stipulated, if the exchange is based on the value of the contract at the end of the trading day on which the contract was stipulated.

For the purposes of sub-paragraph (d), where a margin dispute arises, institutions may recognise the amount of non-disputed collateral that has been exchanged.

(4) For the purposes of paragraph (1), institutions must not include collateral received in the calculation of NICA as defined in Article 272, except in the case of derivative contracts with clients where those contracts are cleared by a QCCP.

(5) For the purposes of paragraph (1), institutions must set the value of the multiplier used in the calculation of the potential future exposure in accordance with Article 278(1) to one, except in the case of derivative contracts with clients where those contracts are cleared by a QCCP.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(6) By way of derogation from paragraph (1), institutions may use the method set out in Article 275 or Articles 276 to 282 to determine the exposure value of derivative contracts listed in paragraphs (1) and (2) of Schedule 2, but only where they also use that method for determining the exposure value of those contracts for the purpose of meeting the own funds requirements set out in Article 92.

Where institutions apply one of the methods referred to in the first sub-paragraph, they must not reduce the total exposure measure by the amount of margin they have received.

Additional provisions on the calculation of the exposure value of written credit derivatives.

429D.(1) For the purposes of this Article, "written credit derivative" means any financial instrument through which an institution effectively provides credit protection including credit default swaps, total return swaps and options where the institution has the obligation to provide credit protection under conditions specified in the options contract.

(2) In addition to the calculation laid down in Article 429C, institutions must include in the calculation of the exposure value of written credit derivatives the effective notional amounts referenced in the written credit derivatives reduced by any negative fair value changes that have been incorporated in Tier 1 capital with respect to those written credit derivatives.

Institutions must calculate the effective notional amount of written credit derivatives by adjusting the notional amount of those derivatives to reflect the true exposure of the contracts that are leveraged or otherwise enhanced by the structure of the transaction.

(3) Institutions may fully or partly reduce the exposure value calculated in accordance with paragraph (2) by the effective notional amount of purchased credit derivatives if all the following conditions are met–

(a) the remaining maturity of the purchased credit derivative is equal to or greater than the remaining maturity of the written credit derivative;

(b) the purchased credit derivative is otherwise subject to the same or more conservative material terms as those in the corresponding written credit derivative;

(c) the purchased credit derivative is not purchased from a counterparty that would expose the institution to Specific Wrong-Way risk, as defined in Article 291(1)(b);

(d) where the effective notional amount of the written credit derivative is reduced by any negative change in fair value incorporated in the institution's Tier 1 capital,

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

the effective notional amount of the purchased credit derivative is reduced by any positive fair value change that has been incorporated in Tier 1 capital;

(e) the purchased credit derivative is not included in a transaction that has been cleared by the institution on behalf of a client or that has been cleared by the institution in its role as a higher-level client in a multi-level client structure and for which the effective notional amount referenced by the corresponding written credit derivative is excluded from the total exposure measure in accordance with Article 429A(1)(g) or (h), as applicable.

For the purpose of calculating the potential future exposure in accordance with Article 429C(1), institutions may exclude from the netting set the portion of a written credit derivative which is not offset in accordance with the first sub-paragraph of this paragraph and for which the effective notional amount is included in the total exposure measure.

(4) For the purposes of paragraph (3)(b)–

(a) if an institution provides written protection via some type of credit derivative, the institution may only recognise offsetting from another purchased credit derivative to the extent that the purchased protection is certain to deliver a payment in all potential future states;

(b) “material term” means any characteristic of the credit derivative that is relevant to the valuation thereof, including the level of subordination, the optionality, the credit events, the underlying reference entity or pool of entities, and the underlying reference obligation or pool of obligations, with the exception of the notional amount and the residual maturity of the credit derivative; and

(c) two reference names must be the same only where they refer to the same legal entity.

(5) By way of derogation from paragraph (3)(b), institutions may use purchased credit derivatives on a pool of reference names to offset written credit derivatives on individual reference names within that pool where the pool of reference entities and the level of subordination in both transactions are the same.

(6) Institutions must not reduce the effective notional amount of written credit derivatives where they buy credit protection through a total return swap and record the net payments received as net income, but do not record any offsetting deterioration in the value of the written credit derivative in Tier 1 capital.

(7) In the case of purchased credit derivatives on a pool of reference obligations–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) institutions may reduce the effective notional amount of written credit derivatives on individual reference obligations by the effective notional amount of purchased credit derivatives in accordance with paragraph (3) only where the protection purchased is economically equivalent to buying protection separately on each of the individual obligations in the pool;

(b) if an institution purchases credit protection on a pool of reference names through credit derivatives, but the credit protection purchased does not cover the entire pool, then the written credit derivatives on the individual reference names may not be offset;

(c) by way of derogation from sub-paragraphs (a) and (b), purchased credit protection may offset written credit derivatives on a pool where the credit protection purchased through credit derivatives covers the entirety of the subset of the pool on which the credit protection has been sold.

Counterparty credit risk add-on for securities financing transactions.

429E.(1) In addition to the calculation of the exposure value of securities financing transactions, including those that are off-balance-sheet in accordance with Article 429B(1), institutions must include in the total exposure measure an add-on for counterparty credit risk calculated in accordance with paragraph (2) or (3), as applicable.

(2) Institutions must calculate the add-on for transactions with a counterparty that are not subject to a master netting agreement that meets the conditions set out in Article 206 on a transaction-by-transaction basis in accordance with the following formula–

$$E_i^* = \max\{0, E_i - C_i\}$$

where–

Ei* = the add-on;

i = the index that denotes the transaction;

Ei = the fair value of securities or cash lent to the counterparty under transaction i; and

Ci = the fair value of securities or cash received from the counterparty under transaction i.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Institutions may set Ei* equal to zero where Ei is the cash lent to a counterparty and the associated cash receivable is not eligible for the netting treatment set out in Article 429B(4).

(3) Institutions must calculate the add-on for transactions with a counterparty that are subject to a master netting agreement that meets the conditions set out in Article 206 on an agreement-by-agreement basis in accordance with the following formula–

$$E_i^* = \max\left\{0, \sum_i E_i - \sum_i C_i\right\}$$

where–

Ei* = the add-on;

i = the index that denotes the netting agreement;

Ei = the fair value of securities or cash lent to the counterparty for the transactions that are subject to master netting agreement i; and

Ci = the fair value of securities or cash received from the counterparty that is subject to master netting agreement i.

(4) For the purposes of paragraphs (2) and (3), the term counterparty also includes tri-party agents that receive collateral in deposit and manage the collateral in the case of tri-party transactions.

(5) By way of derogation from paragraph (1), institutions may use the method set out in Article 222, subject to a 20% floor for the applicable risk weight, to determine the add-on for securities financing transactions including those that are off-balance-sheet. Institutions may use that method only where they also use it for calculating the exposure value of those transactions for the purpose of meeting the own funds requirements as set out in Article 92(1)(a),(b) and (c).

(6) Where sale accounting is achieved for a repurchase transaction under the applicable accounting framework, the institution must reverse all sales-related accounting entries.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(7) Where an institution acts as an agent between two parties in a securities financing transaction, including an off-balance-sheet transaction, the following provisions must apply to the calculation of the institution's total exposure measure–

(a) where the institution provides an indemnity or guarantee to one of the parties in the securities financing transaction and the indemnity or guarantee is limited to any difference between the value of the security or cash the party has lent and the value of collateral the borrower has provided, the institution must only include the add-on calculated in accordance with paragraph (2) or (3), as applicable, in the total exposure measure;

(b) where the institution does not provide an indemnity or guarantee to any of the involved parties, the transaction must not be included in the total exposure measure;

(c) where the institution is economically exposed to the underlying security or the cash in the transaction to an amount greater than the exposure covered by the add-on, it must include in the total exposure measure also the full amount of the security or the cash to which it is exposed;

(d) where the institution acting as agent provides an indemnity or guarantee to both parties involved in a securities financing transaction, the institution must calculate its total exposure measure in accordance with sub-paragraphs (a), (b) and (c) separately for each party involved in the transaction.

Calculation of the exposure value of off-balance-sheet items.

429F.(1) Institutions must calculate, in accordance with Article 111(1), the exposure value of off-balance-sheet items, excluding derivative contracts listed in Schedule 2, credit derivatives, securities financing transactions and positions referred to in Article 429D.

Where a commitment refers to the extension of another commitment, Article 166(9) must apply.

(2) By way of derogation from paragraph (1), institutions may reduce the credit exposure equivalent amount of an off-balance-sheet item by the corresponding amount of specific credit risk adjustments. The calculation is subject to a floor of zero.

(3) By way of derogation from paragraph (1), institutions must apply a conversion factor of 10% to low-risk off-balance-sheet items referred to in Article 111(1)(d).

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Calculation of the exposure value of regular-way purchases and sales awaiting settlement.

429G.(1) Institutions must treat cash related to regular-way sales and securities related to regular-way purchases which remain on the balance sheet until the settlement date as assets in accordance with Article 429(4)(a).

(2) Institutions that, in accordance with the applicable accounting framework, apply trade date accounting to regular-way purchases and sales which are awaiting settlement must reverse out any offsetting between cash receivables for regular-way sales awaiting settlement and cash payables for regular-way purchase awaiting settlement allowed under that framework. After institutions have reversed out the accounting offsetting, they may offset between those cash receivables and cash payables where both the related regular-way sales and purchases are settled on a delivery-versus-payment basis.

(3) Institutions that, in accordance with the applicable accounting framework, apply settlement date accounting to regular-way purchases and sales which are awaiting settlement must include in the total exposure measure the full nominal value of commitments to pay related to regular-way purchases.

Institutions may offset the full nominal value of the commitments to pay related to regular-way purchases by the full nominal value of cash receivables related to regular-way sales awaiting settlement only where both of the following conditions are met–

(a) both the regular-way purchases and sales are settled on a delivery-versus-payment basis;

(b) the financial assets bought and sold that are associated with cash payables and receivables are fair valued through profit and loss and included in the institution's trading book.

PART 7A
REPORTING REQUIREMENTS

Reporting on prudential requirements and financial information.

430.(1) Institutions must report to the GFSC on–

(a) own funds requirements, including the leverage ratio, as set out in Article 92 and Part 7;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(b) the requirements laid down in Articles 92A and 92B, for institutions that are subject to those requirements;

(c) large exposures as set out in Article 394;

(d) liquidity requirements as set out in Article 415;

(e) the aggregate data for each national immovable property market as set out in Article 430A(1);

(f) the requirements set out in the CICR Regulations qualified for standardised reporting, except for any additional reporting requirement under regulation 140(1)(j) of those Regulations; and

(g) the level of asset encumbrance, including a breakdown by the type of asset encumbrance, such as repurchase agreements, securities lending, securitised exposures or loans.

Institutions exempted in accordance with Article 6(5) must not be subject to the reporting requirement on the leverage ratio set out in sub-paragraph (a) of the first sub-paragraph on an individual basis.

(2) In addition to the reporting on the leverage ratio referred to in paragraph (1)(a) and in order to enable the GFSC to monitor leverage ratio volatility, in particular around reporting reference dates, large institutions must report specific components of the leverage ratio to their competent authorities based on averages over the reporting period and the data used to calculate those averages.

(3) In addition to the reporting on prudential requirements referred to in paragraph (1), institutions must report financial information to the GFSC where they are one of the following–

(a) an institution whose securities are admitted to trading on a regulated market; or

(b) a credit institution that prepares its consolidated accounts in accordance with UK-adopted international accounting standards.

(4) The GFSC may require credit institutions that determine their own funds on a consolidated basis in accordance with UK-adopted international accounting standards pursuant to Article 24(2) to report financial information in accordance with this Article.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(5) The reporting on financial information referred to in paragraph (3) must only comprise information that is needed to provide a comprehensive view of the institution's risk profile and the systemic risks posed by the institution to the financial sector or the real economy.

(6) The reporting requirements laid down in this Article apply to institutions in a proportionate manner, having regard to their size, complexity and the nature and level of risk of their activities.

(7) [Not used]

(8) The GFSC may waive the requirement to submit any of the data points set out in any reporting templates where those data points are duplicative. For those purposes, duplicative data points must refer to any data points which are already available to the GFSC by means other than by collecting those reporting templates, including where those data points can be obtained from data that is already available to the GFSC in different formats or levels of granularity; the GFSC may only grant the waivers referred to in this paragraph if data received, collated or aggregated through such alternative methods are identical to those data points which would otherwise have to be reported in accordance with those reporting templates.

Specific reporting obligations.

430A.(1) Institutions must report to the GFSC on an annual basis the following aggregate data for each national immovable property market to which they are exposed–

(a) losses stemming from exposures for which an institution has recognised residential property as collateral, up to the lower of the pledged amount and 80% of the market value or 80% of the mortgage lending value, unless otherwise decided under Article 124(2);

(b) overall losses stemming from exposures for which an institution has recognised residential property as collateral, up to the part of the exposure treated as fully secured by residential property in accordance with Article 124(1);

(c) the exposure value of all outstanding exposures for which an institution has recognised residential property as collateral limited to the part treated as fully secured by residential property in accordance with Article 124(1);

(d) losses stemming from exposures for which an institution has recognised immovable commercial property as collateral, up to the lower of the pledged amount and 50% of the market value or 60% of the mortgage lending value, unless otherwise decided under Article 124(2);

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(e) overall losses stemming from exposures for which an institution has recognised immovable commercial property as collateral, up to the part of the exposure treated as fully secured by immovable commercial property in accordance with Article 124(1);

(f) the exposure value of all outstanding exposures for which an institution has recognised immovable commercial property as collateral limited to the part treated as fully secured by immovable commercial property in accordance with Article 124(1).

(2) The data referred to in paragraph (1) must be reported to the GFSC. The data must be reported separately for the immovable property market within the standards of Gibraltar to which the relevant institution is exposed.

Specific reporting requirements for market risk.

430B.(1) From the date of application of the regulations referred to in Article 461A (to the extent it applies on and after 1st February 2026), institutions that do not meet the conditions set out in Article 94(1) nor the conditions set out in Article 325A(1) must report, for all their trading book positions and all their non-trading book positions that are subject to foreign exchange or commodity risks, the results of the calculations based on using the alternative standardised approach set out in Chapter 1A of Title 4 of Part 3 on the same basis as such institutions report the obligations laid down in Article 92(3)(b)(i) and (c).

(2) Institutions referred to in paragraph (1) must report separately the calculations set out in Article 325C(2)(a), (b) and (c) for the portfolio of all trading book positions or non-trading book positions that are subject to foreign exchange and commodity risks.

(3) [Not used]

(4) For the purposes of the reporting requirement in paragraph (3), institutions must report separately the calculations set out in Article 325BA(1) (a)(i), (a)(ii), (b)(i) and (b)(ii) and for the portfolio of all trading book positions or non-trading book positions that are subject to foreign exchange and commodity risks assigned to trading desks for which the institution has been granted GFSC approval to use the alternative internal model approach in accordance with Article 325AZ(2).

(5) Institutions may use in combination the approaches referred to in paragraphs (1) and (3) within a group if the calculation under the approach referred to in paragraph (1) does not exceed 90% of the total calculation. Otherwise, the institution must use the approach referred to in paragraph (1) for all its trading book positions and all its non-trading book positions that are subject to foreign exchange or commodity risk.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

PART 8
DISCLOSURE BY INSTITUTIONS

TITLE 1
GENERAL PRINCIPLES

Disclosure requirements and policies.

431.(1) Institutions must publicly disclose the information referred to in Titles 2 and 3 in accordance with the provisions laid down in this Title, subject to the exceptions referred to in Article 432.

(2) Institutions that have been granted GFSC approval under Part 3 for the instruments and methodologies referred to in Title 3 of this Part must publicly disclose the information laid down therein.

(3) The management body or senior management must adopt formal policies to comply with the disclosure requirements laid down in this Part and put in place and maintain internal processes, systems and controls to verify that the institutions' disclosures are appropriate and in compliance with the requirements laid down in this Part. At least one member of the management body or senior management must attest in writing that the relevant institution has made the disclosures required under this Part in accordance with the formal policies and internal processes, systems and controls. The written attestation and the key elements of the institution’s formal policies to comply with the disclosure requirements must be included in the institution’s disclosures.

Information to be disclosed in accordance with this Part must be subject to the same level of internal verification as that applicable to the management report included in the institution's financial report.

Institutions must also have policies in place to verify that their disclosures convey their risk profile comprehensively to market participants. Where institutions find that the disclosures required under this Part do not convey the risk profile comprehensively to market participants, they must publicly disclose information in addition to the information required to be disclosed under this Part. Nonetheless, institutions must only be required to disclose information that is material and not proprietary or confidential as referred to in Article 432.

(4) All quantitative disclosures must be accompanied by a qualitative narrative and any other supplementary information that may be necessary in order for the users of that information to understand the quantitative disclosures, noting in particular any significant change in any given disclosure compared to the information contained in the previous disclosures.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(5) Institutions must, if requested, explain their rating decisions to SMEs and other corporate applicants for loans, providing an explanation in writing when asked. The administrative costs of that explanation must be proportionate to the size of the loan.

Non-material, proprietary or confidential information.

432.(1) With the exception of the disclosures laid down in Articles 435(2)(c), 437 and 450, institutions may omit one or more of the disclosures listed in Titles 2 and 3 where the information provided by those disclosures is not regarded as material.

Information in disclosures must be regarded as material where its omission or misstatement could change or influence the assessment or decision of a user of that information relying on it for the purpose of making economic decisions.

(2) Institutions may also omit one or more items of information referred to in Titles 2 and 3 where those items include information that is regarded as proprietary or confidential in accordance with this paragraph, except for the disclosures laid down in Articles 437 and 450.

Information must be regarded as proprietary to institutions where disclosing it publicly would undermine their competitive position. Proprietary information may include information on products or systems that would render the investments of institutions therein less valuable, if shared with competitors.

Information must be regarded as confidential where the institutions are obliged by customers or other counterparty relationships to keep that information confidential.

(3) In the exceptional cases referred to in paragraph (2), the institution concerned must state in its disclosures the fact that specific items of information are not being disclosed and the reason for not disclosing those items, and publish more general information about the subject matter of the disclosure requirement, except where that subject matter is, in itself, proprietary or confidential.

Frequency and scope of disclosures.

433. Institutions must publish the disclosures required under Titles 2 and 3 in the manner set out in Articles 433A, 433B and 433C.

Annual disclosures must be published on the same date as the date on which institutions publish their financial statements or as soon as possible thereafter.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Semi-annual and quarterly disclosures must be published on the same date as the date on which the institutions publish their financial reports for the corresponding period where applicable or as soon as possible thereafter.

Any delay between the date of publication of the disclosures required under this Part and the relevant financial statements must be reasonable and, in any event, must not exceed the timeframe set by the GFSC under regulation 142 of the CICR Regulations.

Disclosures by large institutions.

433A.(1) Large institutions must disclose the information outlined below with the following frequency–

(a) all the information required under this Part on an annual basis;

(b) on a semi-annual basis the information referred to in–

(i) Article 437(a);

(ii) Article 438(e);

(iii) Article 439(e) to (l);

(iv) Article 440;

(v) Article 442(c), (e), (f) and (g);

(vi) Article 444(e);

(vii) Article 445;

(viii) Article 448(1)(a) and (b);

(ix) Article 449(j) to (l);

(x) Article 451(1)(a) and (b);

(xi) Article 451A(3);

(xii) Article 452(g);

(xiii) Article 453(f) to (j);

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(xiv) Article 455(d), (e) and (g);

(c) on a quarterly basis the information referred to in–

(i) Article 438(d) and (h);

(ii) the key metrics referred to in Article 447;

(iii) Article 451A(2).

(2) By way of derogation from paragraph (1), large institutions other than G-SIIs that are non-listed institutions must disclose the information outlined below with the following frequency–

(a) all the information required under this Part on an annual basis;

(b) the key metrics referred to in Article 447 on a semi-annual basis.

(3) Large institutions that are subject to Article 92A or 92B must disclose the information required under Article 437A on a semi-annual basis, except for the key metrics referred to in Article 447(h), which are to be disclosed on a quarterly basis.

Disclosures by small and non-complex institutions.

433B.(1) Small and non-complex institutions must disclose the information outlined below with the following frequency–

(a) on an annual basis the information referred to in–

(i) Article 435(1)(a), (e) and (f);

(ii) Article 438(d);

(iii) Article 450(1)(a) to (d), (h), (i) and (j);

(b) on a semi-annual basis the key metrics referred to in Article 447.

(2) By way of derogation from paragraph (1), small and non-complex institutions that are non-listed institutions must disclose the key metrics referred to in Article 447 on an annual basis.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Disclosures by other institutions.

433C.(1) Institutions that are not subject to Article 433A or 433B must disclose the information outlined below with the following frequency–

(a) all the information required under this Part on an annual basis;

(b) the key metrics referred to in Article 447 on a semi-annual basis.

(2) By way of derogation from paragraph (1), other institutions that are non-listed institutions must disclose the following information on an annual basis–

(a) Article 435(1)(a), (e) and (f);

(b) Article 435(2)(a) to (c);

(c) Article 437(a);

(d) Article 438(c) and (d);

(e) the key metrics referred to in Article 447;

(f) Article 450(1)(a) to (d) and (h) to (k).

Means of disclosures.

434.(1) Institutions must disclose all the information required under Titles 2 and 3 in electronic format and in a single medium or location. The single medium or location must be a standalone document that provides a readily accessible source of prudential information for users of that information or a distinctive section included in or appended to the institutions' financial statements or financial reports containing the required disclosures and being easily identifiable to those users.

(2) Institutions must make available on their website or, in the absence of a website, in any other appropriate location an archive of the information required to be disclosed in accordance with this Part. That archive must be kept accessible for a period of time that must be no less than the storage period set by law for information included in the institutions' financial reports.

434A. [Not used]

TITLE 2
TECHNICAL CRITERIA ON TRANSPARENCE AND DISCLOSURE

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Disclosure of risk management objectives and policies.

435.(1) Institutions must disclose their risk management objectives and policies for each separate category of risk, including the risks referred to in this Title. Those disclosures must include–

(a) the strategies and processes to manage those categories of risks;

(b) the structure and organisation of the relevant risk management function including information on the basis of its authority, its powers and accountability in accordance with the institution's incorporation and governing documents;

(c) the scope and nature of risk reporting and measurement systems;

(d) the policies for hedging and mitigating risk, and the strategies and processes for monitoring the continuing effectiveness of hedges and mitigants;

(e) a declaration approved by the management body on the adequacy of the risk management arrangements of the relevant institution providing assurance that the risk management systems put in place are adequate with regard to the institution's profile and strategy;

(f) a concise risk statement approved by the management body succinctly describing the relevant institution's overall risk profile associated with the business strategy; that statement must include–

(i) key ratios and figures providing external stakeholders a comprehensive view of the institution's management of risk, including how the risk profile of the institution interacts with the risk tolerance set by the management body;

(ii) information on intragroup transactions and transactions with related parties that may have a material impact of the risk profile of the consolidated group.

(2) Institutions must disclose the following information regarding governance arrangements–

(a) the number of directorships held by members of the management body;

(b) the recruitment policy for the selection of members of the management body and their actual knowledge, skills and expertise;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(c) the policy on diversity with regard to selection of members of the management body, its objectives and any relevant targets set out in that policy, and the extent to which those objectives and targets have been achieved;

(d) whether or not the institution has set up a separate risk committee and the number of times the risk committee has met;

(e) the description of the information flow on risk to the management body.

Disclosure of the scope of application.

436. Institutions must disclose the following information regarding the scope of application of these Standards as follows–

(a) the name of the institution to which these Standards applies;

(b) a reconciliation between the consolidated financial statements prepared in accordance with the applicable accounting framework and the consolidated financial statements prepared in accordance with the requirements on regulatory consolidation pursuant to Articles 18 to 24; that reconciliation must outline the differences between the accounting and regulatory scopes of consolidation and the legal entities included within the regulatory scope of consolidation where it differs from the accounting scope of consolidation; the outline of the legal entities included within the regulatory scope of consolidation must describe the method of regulatory consolidation where it is different from the accounting consolidation method, whether those entities are fully or proportionally consolidated and whether the holdings in those legal entities are deducted from own funds;

(c) a breakdown of assets and liabilities of the consolidated financial statements prepared in accordance with the requirements on regulatory consolidation pursuant to Articles 18 to 24, broken down by type of risks as referred to under this Part;

(d) a reconciliation identifying the main sources of differences between the carrying value amounts in the financial statements under the regulatory scope of consolidation as defined in Articles 18 to 24, and the exposure amount used for regulatory purposes; that reconciliation must be supplemented by qualitative information on those main sources of differences;

(e) for exposures from the trading book and the non-trading book that are adjusted in accordance with Article 34 and Article 105, a breakdown of the amounts of the constituent elements of an institution's prudent valuation adjustment, by type of

risks, and the total of constituent elements separately for the trading book and non-trading book positions;

(f) any current or expected material practical or legal impediment to the prompt transfer of own funds or to the repayment of liabilities between the parent undertaking and its subsidiaries;

(g) the aggregate amount by which the actual own funds are less than required in all subsidiaries that are not included in the consolidation, and the name or names of those subsidiaries;

(h) where applicable, the circumstances under which use is made of the derogation referred to in Article 7 or the individual consolidation method laid down in Article 9.

Disclosure of own funds.

437. Institutions must disclose the following information regarding their own funds–

(a) a full reconciliation of Common Equity Tier 1 items, Additional Tier 1 items, Tier 2 items and the filters and deductions applied to own funds of the institution pursuant to Articles 32 to 36, 56, 66 and 79 with the balance sheet in the audited financial statements of the institution;

(b) a description of the main features of the Common Equity Tier 1 and Additional Tier 1 instruments and Tier 2 instruments issued by the institution;

(c) the full terms and conditions of all Common Equity Tier 1, Additional Tier 1 and Tier 2 instruments;

(d) a separate disclosure of the nature and amounts of the following–

(i) each prudential filter applied pursuant to Articles 32 to 35;

(ii) items deducted pursuant to Articles 36, 56 and 66;

(iii) items not deducted pursuant to Articles 47, 48, 56, 66 and 79;

(e) a description of all restrictions applied to the calculation of own funds in accordance with these Standards and the instruments, prudential filters and deductions to which those restrictions apply;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(f) a comprehensive explanation of the basis on which capital ratios are calculated where those capital ratios are calculated by using elements of own funds determined on a basis other than the basis laid down in these Standards.

Disclosure of own funds and eligible liabilities.

437A. Institutions that are subject to Article 92A or 92B must disclose the following information regarding their own funds and eligible liabilities–

(a) the composition of their own funds and eligible liabilities, their maturity and their main features;

(b) the ranking of eligible liabilities in the creditor hierarchy;

(c) the total amount of each issuance of eligible liabilities instruments referred to in Article 72B and the amount of those issuances that is included in eligible liabilities items within the limits specified in Article 72B(3) and (4);

(d) the total amount of excluded liabilities referred to in Article 72A(2).

Disclosure of own funds requirements and risk-weighted exposure amounts.

438. Institutions must disclose the following information regarding their compliance with Article 92 and with the requirements of regulations 30 and 140(1)(a) of the CICR Regulations–

(a) a summary of their approach to assessing the adequacy of their internal capital to support current and future activities;

(b) the amount of the additional own funds requirements based on the supervisory review process as referred to in regulation 140(1)(a) of the CICR Regulations and its composition in terms of Common Equity Tier 1, additional Tier 1 and Tier 2 instruments;

(c) upon demand from the GFSC, the result of the institution's internal capital adequacy assessment process;

(d) the total risk-weighted exposure amount and the corresponding total own funds requirement determined in accordance with Article 92, to be broken down by the different risk categories set out in Part 3 and, where applicable, an explanation of the effect on the calculation of own funds and risk-weighted exposure amounts that results from applying capital floors and not deducting items from own funds;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(e) the on- and off-balance-sheet exposures, the risk-weighted exposure amounts and associated expected losses for each category of specialised lending referred to in Table 1 of Article 153(5) and the on- and off-balance-sheet exposures and risk-weighted exposure amounts for the categories of equity exposures set out in Article 155(2);

(f) the exposure value and the risk-weighted exposure amount of own funds instruments held in any insurance undertaking, reinsurance undertaking or insurance holding company that the institutions do not deduct from their own funds in accordance with Article 49 when calculating their capital requirements on an individual, sub-consolidated and consolidated basis;

(g) the supplementary own funds requirement and the capital adequacy ratio of the financial conglomerate calculated in accordance with regulation 6 of and Schedule 1 to the Financial Services (Financial Conglomerates) Regulations 2020, where method 1 or 2 set out in that Schedule is applied;

(h) the variations in the risk-weighted exposure amounts of the current disclosure period compared to the immediately preceding disclosure period that result from the use of internal models, including an outline of the key drivers explaining those variations.

Disclosure of exposures to counterparty credit risk.

439. Institutions must disclose the following information regarding their exposure to counterparty credit risk as referred to in Chapter 6 of Title 2 of Part 3–

(a) a description of the methodology used to assign internal capital and credit limits for counterparty credit exposures, including the methods to assign those limits to exposures to central counterparties;

(b) a description of policies related to guarantees and other credit risk mitigants, such as the policies for securing collateral and establishing credit reserves;

(c) a description of policies with respect to General Wrong-Way risk and Specific Wrong-Way risk as defined in Article 291;

(d) the amount of collateral the institution would have to provide if its credit rating was downgraded;

(e) for derivative transactions, the amount of segregated and unsegregated collateral received and posted per type of collateral; and for securities financing transactions,

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

the total amount of collateral received and posted per type of collateral; provided in each case that–

(i) institutions must not disclose such amounts unless both the fair value of collateral posted in the form of debt securities and the fair value of collateral received in that form exceed £125 billion; and

(ii) for the purposes of sub-paragraph (i), institutions must use the twelve month rolling arithmetic mean of the fair value of collateral received or posted (as the case may be) the form of debt securities, determined using quarterly data calculated in a manner consistent with data reported under Article 430(g) and covering the twelve months immediately preceding the disclosure reference date;

(f) for derivative transactions, the exposure values before and after the effect of the credit risk mitigation as determined under the methods set out in Articles 274 to 294, whichever method is applicable, and the associated risk exposure amounts broken down by applicable method;

(g) for securities financing transactions, the exposure values before and after the effect of the credit risk mitigation as determined under the methods set out in Chapters 4 and 6 of Title 2 of Part 3, whichever method is used, and the associated risk exposure amounts broken down by applicable method;

(h) the exposure values after credit risk mitigation effects and the associated risk exposures for credit valuation adjustment capital charge, separately for each method as set out in Title 6 of Part 3;

(i) the exposure value to central counterparties and the associated risk exposures within the scope of Articles 300 to 311, separately for qualifying and non-qualifying central counterparties, and broken down by types of exposures;

(j) the notional amounts and fair value of credit derivative transactions; credit derivative transactions must be broken down by product type; within each product type, credit derivative transactions must be broken down further by credit protection bought and credit protection sold;

(k) the estimate of alpha where the institution has received GFSC approval to use its own estimate of alpha in accordance with Article 284(9); and

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(l) for institutions using the methods set out in Articles 275 to 282, the size of their on- and off-balance-sheet derivative business as calculated in accordance with Article 273A(1) or (2), as applicable.

Disclosure of countercyclical capital buffers.

440. Institutions must disclose the following information in relation to their compliance with the requirement for a countercyclical capital buffer as referred to in Chapter 3 of Part 5 of the CICR Regulations–

(a) the geographical distribution of the exposure amounts and risk-weighted exposure amounts of its credit exposures used as a basis for the calculation of their countercyclical capital buffer;

(b) the amount of their institution-specific countercyclical capital buffer.

Disclosure of indicators of global systemic importance.

441. G-SIIs must disclose, on an annual basis, the values of the indicators used for determining their score in accordance with the identification methodology referred to in regulation 85 of the CICR Regulations.

Disclosure of exposures to credit risk and dilution risk.

442. Institutions must disclose the following information regarding their exposures to credit risk and dilution risk–

(a) the scope and definitions that they use for accounting purposes of "past due" and "impaired" and the differences, if any, between the definitions of 'past due' and 'default' for accounting and regulatory purposes;

(b) a description of the approaches and methods adopted for determining specific and general credit risk adjustments;

(c) information on the amount and quality of performing, non-performing and forborne exposures for loans, debt securities and off-balance-sheet exposures, including their related accumulated impairment, provisions and negative fair value changes due to credit risk and amounts of collateral and financial guarantees received;

(d) an ageing analysis of accounting past due exposures;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(e) the gross carrying amounts of both defaulted and non-defaulted exposures, the accumulated specific and general credit risk adjustments, the accumulated write-offs taken against those exposures and the net carrying amounts and their distribution by geographical area and industry type and for loans, debt securities and off-balance-sheet exposures;

(f) any changes in the gross amount of defaulted on- and off-balance-sheet exposures, including, as a minimum, information on the opening and closing balances of those exposures, the gross amount of any of those exposures reverted to non-defaulted status or subject to a write-off;

(g) the breakdown of loans and debt securities by residual maturity.

Disclosure of encumbered and unencumbered assets.

443. Institutions must disclose information concerning their encumbered and unencumbered assets. For those purposes, institutions must use the carrying amount per exposure class broken down by asset quality and the total amount of the carrying amount that is encumbered and unencumbered. Disclosure of information on encumbered and unencumbered assets must not reveal emergency liquidity assistance provided by central banks.

Disclosure of the use of the Standardised Approach.

444. Institutions calculating their risk-weighted exposure amounts in accordance with Chapter 2 of Title 2 of Part 3 must disclose the following information for each of the exposure classes set out in Article 112–

(a) the names of the nominated ECAIs and the reasons for any changes in those nominations over the disclosure period;

(b) the exposure classes for which each ECAI is used;

(c) a description of the process used to transfer the issuer and issue credit ratings onto items not included in the trading book;

(d) the association of the external rating of each nominated ECAI with the risk weights that correspond to the credit quality steps as set out in Chapter 2 of Title 2 of Part 3, taking into account that it is not necessary to disclose that information where the institutions comply with any standard association published by the GFSC;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(e) the exposure values and the exposure values after credit risk mitigation associated with each credit quality step as set out in Chapter 2 of Title 2 of Part 3, by exposure class, as well as the exposure values deducted from own funds.

Disclosure of exposure to market risk.

445. Institutions calculating their own funds requirements in accordance with Article 92(3)(b) and (c) must disclose those requirements separately for each risk referred to in those sub-paragraphs. In addition, own funds requirements for the specific interest rate risk of securitisation positions must be disclosed separately.

Disclosure of operational risk management.

446. Institutions must disclose the following information about their operational risk management–

(a) the approaches for the assessment of own funds requirements for operation risk that the institution qualifies for;

(b) where the institution makes use of it, a description of the methodology set out in Article 312(2), which must include a discussion of the relevant internal and external factors being considered in the institution's advanced measurement approach;

(c) in the case of partial use, the scope and coverage of the different methodologies used.

Disclosure of key metrics.

447. Institutions must disclose the following key metrics in a tabular format–

(a) the composition of their own funds and their own funds requirements as calculated in accordance with Article 92;

(b) the total risk exposure amount as calculated in accordance with Article 92(3);

(c) where applicable, the amount and composition of additional own funds which the institutions are required to hold in accordance with regulation 140(1)(a) of the CICR Regulations;

(d) their combined buffer requirement which the institutions are required to hold in accordance with Chapter 3 of Part 5 of the CICR Regulations;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(e) their leverage ratio and the total exposure measure as calculated in accordance with Article 429;

(f) the following information in relation to their liquidity coverage ratio as calculated in accordance with Part 4 of Schedule 4–

(i) the average or averages, as applicable, of their liquidity coverage ratio based on end-of-the-month observations over the preceding 12 months for each quarter of the relevant disclosure period;

(ii) the average or averages, as applicable, of total liquid assets, after applying the relevant haircuts, included in the liquidity buffer under Part 4 of Schedule 4, based on end-of-the-month observations over the preceding 12 months for each quarter of the relevant disclosure period;

(iii) the averages of their liquidity outflows, inflows and net liquidity outflows as calculated under Part 4 of Schedule 4, based on end-of-the-month observations over the preceding 12 months for each quarter of the relevant disclosure period;

(g) the following information in relation to their net stable funding requirement as calculated in accordance with Title 4 of Part 6–

(i) the net stable funding ratio at the end of each quarter of the relevant disclosure period;

(ii) the available stable funding at the end of each quarter of the relevant disclosure period;

(iii) the required stable funding at the end of each quarter of the relevant disclosure period;

(h) their own funds and eligible liabilities ratios and their components, numerator and denominator, as calculated in accordance with Articles 92A and 92B and broken down at the level of each resolution group, where applicable.

Disclosure of exposures to interest rate risk on positions not held in the trading book.

448.(1) Institutions must disclose the following quantitative and qualitative information on the risks arising from potential changes in interest rates that affect both the economic value of

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

equity and the net interest income of their non-trading book activities referred to in regulations 41 and 55(7) of the CICR Regulations–

(a) the changes in the economic value of equity calculated under the six supervisory shock scenarios referred to in regulation 55(7) of the CICR Regulations for the current and previous disclosure periods;

(b) the changes in the net interest income calculated under the two supervisory shock scenarios referred to in regulation 55(7) of the CICR Regulations for the current and previous disclosure periods;

(c) a description of key modelling and parametric assumptions, other than those referred to in regulation 55(13)(b) and (c) of the CICR Regulations points used to calculate changes in the economic value of equity and in the net interest income required under sub-paragraphs (a) and (b);

(d) an explanation of the significance of the risk measures disclosed under sub-paragraphs (a) and (b) and of any significant variations of those risk measures since the previous disclosure reference date;

(e) the description of how institutions define, measure, mitigate and control the interest rate risk of their non-trading book activities for the purposes of the competent authorities' review in accordance with regulation 41 of the CICR Regulations, including–

(i) a description of the specific risk measures that the institutions use to evaluate changes in their economic value of equity and in their net interest income;

(ii) a description of the key modelling and parametric assumptions used in the institutions' internal measurement systems that would differ from the common modelling and parametric assumptions referred to in regulation 55(13) of the CICR Regulations for the purpose of calculating changes to the economic value of equity and to the net interest income, including the rationale for those differences;

(iii) a description of the interest rate shock scenarios that institutions use to estimate the interest rate risk;

(iv) the recognition of the effect of hedges against those interest rate risks, including internal hedges that meet the requirements in Article 106(3);

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(v) an outline of how often the evaluation of the interest rate risk occurs;

(f) the description of the overall risk management and mitigation strategies for those risks;

(g) average and longest repricing maturity assigned to non-maturity deposits.

(2) By way of derogation from paragraph (1), the requirements set out in paragraph (1)(c) and (e)(i) to (e)(iv) must not apply to institutions that use the standardised methodology or the simplified standardised methodology referred to in regulation 41 of the CICR Regulations.

Disclosure of exposures to securitisation positions.

449. Institutions calculating risk-weighted exposure amounts in accordance with Chapter 5 of Title 2 of Part 3 or own funds requirements in accordance with Article 337 or 338 must disclose the following information separately for their trading book and non-trading book activities–

(a) a description of their securitisation and re-securitisation activities, including their risk management and investment objectives in connection with those activities, their role in securitisation and re-securitisation transactions, whether they use the simple, transparent and standardised securitisation (STS) as defined in Article 242, and the extent to which they use securitisation transactions to transfer the credit risk of the securitised exposures to third parties with, where applicable, a separate description of their synthetic securitisation risk transfer policy;

(b) the type of risks they are exposed to in their securitisation and re-securitisation activities by level of seniority of the relevant securitisation positions providing a distinction between STS and non-STS positions and–

(i) the risk retained in own-originated transactions;

(ii) the risk incurred in relation to transactions originated by third parties;

(c) their approaches for calculating the risk-weighted exposure amounts that they apply to their securitisation activities, including the types of securitisation positions to which each approach applies and with a distinction between STS and non-STS positions;

(d) a list of SSPEs falling into any of the following categories, with a description of their types of exposures to those SSPEs, including derivative contracts–

(i) SSPEs which acquire exposures originated by the institutions;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(ii) SSPEs sponsored by the institutions;

(iii) SSPEs and other legal entities for which the institutions provide securitisation-related services, such as advisory, asset servicing or management services;

(iv) SSPEs included in the institutions' regulatory scope of consolidation;

(e) a list of any legal entities in relation to which the institutions have disclosed that they have provided support in accordance with Chapter 5 of Title 2 of Part 3;

(f) a list of legal entities affiliated with the institutions and that invest in securitisations originated by the institutions or in securitisation positions issued by SSPEs sponsored by the institutions;

(g) a summary of their accounting policies for securitisation activity, including where relevant a distinction between securitisation and re-securitisation positions;

(h) the names of the ECAIs used for securitisations and the types of exposure for which each agency is used;

(i) where applicable, a description of the Internal Assessment Approach as set out in Chapter 5 of Title 2 of Part 3, including the structure of the internal assessment process and the relation between internal assessment and external ratings of the relevant ECAI disclosed in accordance with sub-paragraph (h), the control mechanisms for the internal assessment process including discussion of independence, accountability, and internal assessment process review, the exposure types to which the internal assessment process is applied and the stress factors used for determining credit enhancement levels;

(j) separately for the trading book and the non-trading book, the carrying amount of securitisation exposures, including information on whether institutions have transferred significant credit risk in accordance with Articles 244 and 245, for which institutions act as originator, sponsor or investor, separately for traditional and synthetic securitisations, and for STS and non-STS transactions and broken down by type of securitisation exposures;

(k) for the non-trading book activities, the following information–

(i) the aggregate amount of securitisation positions where institutions act as originator or sponsor and the associated risk-weighted assets and capital

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

requirements by regulatory approaches, including exposures deducted from own funds or risk weighted at 1,250%, broken down between traditional and synthetic securitisations and between securitisation and re-securitisation exposures, separately for STS and non-STS positions, and further broken down into a meaningful number of risk-weight or capital requirement bands and by approach used to calculate the capital requirements;

(ii) the aggregate amount of securitisation positions where institutions act as investor and the associated risk-weighted assets and capital requirements by regulatory approaches, including exposures deducted from own funds or risk weighted at 1,250%, broken down between traditional and synthetic securitisations, securitisation and re-securitisation positions, and STS and non-STS positions, and further broken down into a meaningful number of risk weight or capital requirement bands and by approach used to calculate the capital requirements;

(l) for exposures securitised by the institution, the amount of exposures in default and the amount of the specific credit risk adjustments made by the institution during the current period, both broken down by exposure type.

Disclosure of environmental, social and governance risks (ESG risks).

449A. From 1st January 2024, large institutions which have issued securities that are admitted to trading on a regulated market, within the meaning of paragraph 1 of Schedule 2 to the Act, must disclose information on ESG risks, including physical risks and transition risks.

The information referred to in the first paragraph must be disclosed on an annual basis for the first year and biannually after that.

Disclosure of remuneration policy.

450.(1) Institutions must disclose the following information regarding their remuneration policy and practices for those categories of staff whose professional activities have a material impact on the risk profile of the institutions–

(a) information concerning the decision-making process used for determining the remuneration policy, as well as the number of meetings held by the main body overseeing remuneration during the financial year, including, where applicable, information about the composition and the mandate of a remuneration committee, the external consultant whose services have been used for the determination of the remuneration policy and the role of the relevant stakeholders;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(b) information about the link between pay of the staff and their performance;

(c) the most important design characteristics of the remuneration system, including information on the criteria used for performance measurement and risk adjustment, deferral policy and vesting criteria;

(d) the ratios between fixed and variable remuneration set in accordance with regulation 51(8) of the CICR Regulations;

(e) information on the performance criteria on which the entitlement to shares, options or variable components of remuneration is based;

(f) the main parameters and rationale for any variable component scheme and any other non-cash benefits;

(g) aggregate quantitative information on remuneration, broken down by business area;

(h) aggregate quantitative information on remuneration, broken down by senior management and members of staff whose professional activities have a material impact on the risk profile of the institutions, indicating the following–

(i) the amounts of remuneration awarded for the financial year, split into fixed remuneration including a description of the fixed components, and variable remuneration, and the number of beneficiaries;

(ii) the amounts and forms of awarded variable remuneration, split into cash, shares, share-linked instruments and other types separately for the part paid upfront and the deferred part;

(iii) the amounts of deferred remuneration awarded for previous performance periods, split into the amount due to vest in the financial year and the amount due to vest in subsequent years;

(iv) the amount of deferred remuneration due to vest in the financial year that is paid out during the financial year, and that is reduced through performance adjustments;

(v) the guaranteed variable remuneration awards during the financial year, and the number of beneficiaries of those awards;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(vi) the severance payments awarded in previous periods, that have been paid out during the financial year;

(vii) the amounts of severance payments awarded during the financial year, split into paid upfront and deferred, the number of beneficiaries of those payments and highest payment that has been awarded to a single person;

(i) the number of individuals that have been remunerated €1 million or more per financial year, with the remuneration between €1 million and €5 million broken down into pay bands of €500,000 and with the remuneration of €5 million and above broken down into pay bands of €1 million;

(j) upon demand from the GFSC, the total remuneration for each member of the management body or senior management;

(k) information on whether the institution benefits from a derogation laid down in regulation 51(18A) of the CICR Regulations.

For the purposes of sub-paragraph (k), institutions that benefit from such a derogation must indicate whether they benefit from that derogation on the basis of regulation 51(18A)(a) or (b) of the CICR Regulations. They must also indicate for which of the remuneration principles they apply the derogation(s), the number of staff members that benefit from the derogation(s) and their total remuneration, split into fixed and variable remuneration.

(2) For large institutions, the quantitative information on the remuneration of institutions' collective management body referred to in this Article must also be made available to the public, differentiating between executive and non-executive members.

Institutions must comply with the requirements set out in this Article in a manner that is appropriate to their size, internal organisation and the nature, scope and complexity of their activities and without prejudice to the data protection legislation.

Disclosure of the leverage ratio.

451.(1) Institutions that are subject to Part 7 must disclose the following information regarding their leverage ratio as calculated in accordance with Article 429 and their management of the risk of excessive leverage–

(a) the leverage ratio and how the institutions apply Article 499(2);

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(b) a breakdown of the total exposure measure referred to in Article 429(4), as well as a reconciliation of the total exposure measure with the relevant information disclosed in published financial statements;

(c) [Not used]

(d) a description of the processes used to manage the risk of excessive leverage;

(e) a description of the factors that had an impact on the leverage ratio during the period to which the disclosed leverage ratio refers.

(2) Public development credit institutions as defined in Article 429A(2) must disclose the leverage ratio without the adjustment to the total exposure measure determined in accordance with sub-paragraph (d) of the first sub-paragraph of Article 429A(1).

(3) In addition to paragraph (1)(a) and (b), large institutions must disclose the leverage ratio and the breakdown of the total exposure measure referred to in Article 429(4) based on averages calculated in accordance with the implementing act referred to in Article 430(7).

Disclosure of liquidity requirements.

451A.(1) Institutions that are subject to Part 6 must disclose information on their liquidity coverage ratio, net stable funding ratio and liquidity risk management in accordance with this Article.

(2) Institutions must disclose the following information in relation to their liquidity coverage ratio as calculated in accordance with Part 4 of Schedule 4–

(a) the average or averages, as applicable, of their liquidity coverage ratio based on end-of-the-month observations over the preceding 12 months for each quarter of the relevant disclosure period;

(b) the average or averages, as applicable, of total liquid assets, after applying the relevant haircuts, included in the liquidity buffer under Part 4 of Schedule 4, based on end-of-the-month observations over the preceding 12 months for each quarter of the relevant disclosure period, and a description of the composition of that liquidity buffer;

(c) the averages of their liquidity outflows, inflows and net liquidity outflows as calculated in accordance with Part 4 of Schedule 4, based on end-of-the-month observations over the preceding 12 months for each quarter of the relevant disclosure period and the description of their composition.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(3) Institutions must disclose the following information in relation to their net stable funding ratio as calculated in accordance with Title 4 of Part 6–

(a) quarter-end figures of their net stable funding ratio calculated in accordance with Chapter 2 of Title 4 of Part 6 for each quarter of the relevant disclosure period;

(b) an overview of the amount of available stable funding calculated in accordance with Chapter 3 of Title 4 of Part 6;

(c) an overview of the amount of required stable funding calculated in accordance with Chapter 4 of Title 4 of Part 6.

(4) Institutions must disclose the arrangements, systems, processes and strategies put in place to identify, measure, manage and monitor their liquidity risk in accordance with regulation 43 of the CICR Regulations.

TITLE 3
QUALIFYING REQUIREMENTS FOR THE USE OF PARTICULAR INSTRUMENTS OR METHODOLOGIES

Disclosure of the use of the IRB Approach to credit risk.

452. Institutions calculating the risk-weighted exposure amounts under the IRB Approach to credit risk must disclose the following information–

(a) the GFSC's approval of the approach or approved transition;

(b) for each exposure class referred to in Article 147, the percentage of the total exposure value of each exposure class subject to the Standardised Approach laid down in Chapter 2 of Title 2 of Part 3 or to the IRB Approach laid down in Chapter 3 of Title 2 of Part 3, as well as the part of each exposure class subject to a roll-out plan; where institutions have received approval to use own LGDs and conversion factors for the calculation of risk-weighted exposure amounts, they must disclose separately the percentage of the total exposure value of each exposure class subject to that approval;

(c) the control mechanisms for rating systems at the different stages of model development, controls and changes, which must include information on–

(i) the relationship between the risk management function and the internal audit function;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(ii) the rating system review;

(iii) the procedure to ensure the independence of the function in charge of reviewing the models from the functions responsible for the development of the models;

(iv) the procedure to ensure the accountability of the functions in charge of developing and reviewing the models;

(d) the role of the functions involved in the development, approval and subsequent changes of the credit risk models;

(e) the scope and main content of the reporting related to credit risk models;

(f) a description of the internal ratings process by exposure class, including the number of key models used with respect to each portfolio and a brief discussion of the main differences between the models within the same portfolio, covering–

(i) the definitions, methods and data for estimation and validation of PD, which must include information on how PDs are estimated for low default portfolios, whether there are regulatory floors and the drivers for differences observed between PD and actual default rates at least for the last three periods;

(ii) where applicable, the definitions, methods and data for estimation and validation of LGD, such as methods to calculate downturn LGD, how LGDs are estimated for low default portfolio and the time lapse between the default event and the closure of the exposure;

(iii) where applicable, the definitions, methods and data for estimation and validation of conversion factors, including assumptions employed in the derivation of those variables;

(g) as applicable, the following information in relation to each exposure class referred to in Article 147–

(i) their gross on-balance-sheet exposure;

(ii) their off-balance-sheet exposure values prior to the relevant conversion factor;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(iii) their exposure after applying the relevant conversion factor and credit risk mitigation;

(iv) any model, parameter or input relevant for the under-standing of the risk weighting and the resulting risk exposure amounts disclosed across a sufficient number of obligor grades (including default) to allow for a meaningful differentiation of credit risk;

(v) separately for those exposure classes in relation to which institutions have received approval to use own LGDs and conversion factors for the calculation of risk-weighted exposure amounts, and for exposures for which the institutions do not use such estimates, the values referred to in paragraphs (i) to (iv) subject to that approval;

(h) institutions' estimates of PDs against the actual default rate for each exposure class over a longer period, with separate disclosure of the PD range, the external rating equivalent, the weighted average and arithmetic average PD, the number of obligors at the end of the previous year and of the year under review, the number of defaulted obligors, including the new defaulted obligors, and the annual average historical default rate.

For the purposes of sub-paragraph (b), institutions must use the exposure value as defined in Article 166.

Disclosure of the use of credit risk mitigation techniques.

453. Institutions using credit risk mitigation techniques must disclose the following information–

(a) the core features of the policies and processes for on- and off-balance-sheet netting and an indication of the extent to which institutions make use of balance sheet netting;

(b) the core features of the policies and processes for eligible collateral evaluation and management;

(c) a description of the main types of collateral taken by the institution to mitigate credit risk;

(d) for guarantees and credit derivatives used as credit protection, the main types of guarantor and credit derivative counterparty and their creditworthiness used for the

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

purpose of reducing capital requirements, excluding those used as part of synthetic securitisation structures;

(e) information about market or credit risk concentrations within the credit risk mitigation taken;

(f) for institutions calculating risk-weighted exposure amounts under the Standardised Approach or the IRB Approach, the total exposure value not covered by any eligible credit protection and the total exposure value covered by eligible credit protection after applying volatility adjustments; the disclosure set out in this sub-paragraph must be made separately for loans and debt securities and including a breakdown of defaulted exposures;

(g) the corresponding conversion factor and the credit risk mitigation associated with the exposure and the incidence of credit risk mitigation techniques with and without substitution effect;

(h) for institutions calculating risk-weighted exposure amounts under the Standardised Approach, the on- and off-balance- sheet exposure value by exposure class before and after the application of conversion factors and any associated credit risk mitigation;

(i) for institutions calculating risk-weighted exposure amounts under the Standardised Approach, the risk-weighted exposure amount and the ratio between that risk-weighted exposure amount and the exposure value after applying the corresponding conversion factor and the credit risk mitigation associated with the exposure; the disclosure set out in this sub-paragraph must be made separately for each exposure class;

(j) for institutions calculating risk-weighted exposure amounts under the IRB Approach, the risk-weighted exposure amount before and after recognition of the credit risk mitigation impact of credit derivatives; where institutions have received approval to use own LGDs and conversion factors for the calculation of risk-weighted exposure amounts, they must make the disclosure set out in this sub-paragraph separately for the exposure classes subject to that approval.

Disclosure of the use of the Advanced Measurement Approaches to operational risk.

454. The institutions using the Advanced Measurement Approaches set out in Articles 321 to 324 for the calculation of their own funds requirements for operational risk must disclose a description of their use of insurance and other risk-transfer mechanisms for the purpose of mitigating that risk.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Use of internal market risk models.

455. Institutions calculating their capital requirements in accordance with Article 363 must disclose the following information–

(a) for each sub-portfolio covered–

(i) the characteristics of the models used;

(ii) where applicable, for the internal models for incremental default and migration risk and for correlation trading, the methodologies used and the risks measured through the use of an internal model including a description of the approach used by the institution to determine liquidity horizons, the methodologies used to achieve a capital assessment that is consistent with the required soundness standard and the approaches used in the validation of the model;

(iii) a description of stress testing applied to the sub-portfolio;

(iv) a description of the approaches used for back-testing and validating the accuracy and consistency of the internal models and modelling processes;

(b) the scope of the GFSC's approval;

(c) a description of the extent and methodologies for compliance with the requirements set out in Articles 104 and 105;

(d) the highest, the lowest and the mean of the following–

(i) the daily value-at-risk measures over the reporting period and at the end of the reporting period;

(ii) the stressed value-at-risk measures over the reporting period and at the end of the reporting period;

(iii) the risk numbers for incremental default and migration risk and for the specific risk of the correlation trading portfolio over the reporting period and at the end of the reporting period;

(e) the elements of the own funds requirement as specified in Article 364;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(f) the weighted average liquidity horizon for each sub-portfolio covered by the internal models for incremental default and migration risk and for correlation trading;

(g) a comparison of the daily end-of-day value-at-risk measures to the one-day changes of the portfolio's value by the end of the subsequent business day together with an analysis of any important over-shooting during the reporting period.

PART 9
PRUDENTIAL MEASURES

456. to 457. [Not used]

Enhanced prudential requirements.

458.(1) The GFSC must notify the Minister if the GFSC–

(a) identifies changes in the intensity of micro-prudential, macro-prudential or systemic risk with the potential to have serious negative consequences for the financial system or economy in Gibraltar; and

(b) considers that those risks would be addressed better by means of stricter measures than those in these Standards and the CICR Regulations.

(2) A notification under paragraph (1) must–

(a) be supported by relevant quantitative or qualitative evidence, including–

(i) the changes identified;

(ii) the reasons why those changes could pose a threat to domestic financial stability; and

(iii) the reasons why the provisions of these Standards and the CICR Regulations cannot adequately address the risk identified;

(b) be accompanied by draft proposals intended to mitigate the changes in the intensity of risk and concerning–

(i) the level of own funds laid down in Article 92;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(ii) the requirements for large exposures laid down in Article 392 and Article 395 to 403;

(iii) the public disclosure requirements laid down in Articles 431 to 455;

(iv) the level of the capital conservation buffer laid down in regulation 83 of the CICR Regulations;

(v) liquidity requirements laid down in Part 6;

(vi) risk weights for targeting asset bubbles in the residential property and commercial immovable property sector; or

(vii) intra financial sector exposures.

(3) to (4) [Not used]

459. to 460. [Not used]

461A. [Not used]

462 to 464. [Not used]

PART 10
TRANSITIONAL PROVISIONS, REPORTS, REVIEWS AND AMENDMENTS

TITLE 1
TRANSITIONAL PROVISIONS

Own funds requirements

465. [Not used]

First time application of International Financial Reporting Standards.

466. By way of derogation from Article 24(2), the GFSC may grant institutions which are required to effect the valuation of assets and off-balance sheet items and the determination of own funds in accordance with UK-adopted international accounting standards for the first time a lead time of 24 months for the implementation of the necessary internal processes and technical requirements.

467. to 480. [Not used]

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Additional filters and deductions

481. [Not used]

Scope of application for derivatives transactions with pension funds.

482. In respect of those transactions referred to in Article 89 of EMIR and entered into with a pension scheme arrangement as defined in Article 2 of that Regulation, institutions must not calculate own funds requirements for CVA risk as provided for in Article 382(4)(c).

483 to 492. [Not used]

CHAPTER 4
LARGE EXPOSURES, OWN FUNDS REQUIREMENTS, LEVERAGE AND BASEL I FLOOR

493. to 500D. [Not used]

Adjustment of risk-weighted non-defaulted SME exposures.

501.(1) Institutions must adjust the risk-weighted exposure amounts for non-defaulted exposures to an SME (RWEA), which are calculated in accordance with Chapter 2 or 3 of Title 2 of Part 3, as applicable, in accordance with the following formula–

$$\mathbf{RWEA}^{*} = \mathbf{RWEA} \times \frac{\min\left\{E^{*};\ \text{EUR}2500000\right\} \times 0{,}7619 + \max\left\{E^{*} - \text{EUR}\ 2500000;\ 0\right\} \times 0{,}85}{E^{*}}$$

where–

RWEA* = the RWEA adjusted by an SME supporting factor; and

E* = the total amount owed to the institution, its subsidiaries, its parent undertakings and other subsidiaries of those parent undertakings, including any exposure in default, but excluding claims or contingent claims secured on residential property collateral, by the SME or the group of connected clients of the SME.

(2) For the purposes of this Article–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) the exposure to an SME must be included either in the retail or in the corporates or secured by mortgages on immovable property classes;

(b) an SME is defined in accordance with Commission Recommendation 2003/361/EC; but–

(i) in Article 2 of the Annex to that Recommendation, only the annual turnover must be taken into account;

(ii) Article 3.5 of that Annex must apply as if for "by national or Community rules" there were substituted "under the law of Gibraltar"; and

(iii) Article 5(b) of that Annex must apply as if for "national law" there were substituted " the law of the Gibraltar";

(c) institutions must take reasonable steps to correctly determine E* and obtain the information required under sub-paragraph (b).

Articles 501A to 520. [Not used]

PART 11
FINAL PROVISIONS

521. [Not used]

Saving for pre-exit decisions.

522.(1) A decision which was made under Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and amending Regulation (EU) No 648/2012 as it applied before IP completion day by–

(a) a body other than the GFSC; or

(b) another body acting jointly with the GFSC,

is to continue to have effect, with any necessary modifications, on and after IP completion day.

(2) After IP completion day, a decision to which paragraph (1) applies is to be treated as if it were made by the GFSC.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(3) The GFSC may review, vary, modify or revoke a decision to which paragraph (1) applies and has the same powers in respect of that decision on and after IP completion day as if it were a decision which the GFSC could have made before IP completion day.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

SCHEDULE 1
CLASSIFICATION OF OFF-BALANCE SHEET ITEMS

1. Full risk–

    (a) guarantees having the character of credit substitutes, (e.g. guarantees for the good payment of credit facilities);

    (b) credit derivatives;

    (c) acceptances;

    (d) endorsements on bills not bearing the name of another institution or investment firm;

    (e) transactions with recourse (e.g. factoring, invoice discount facilities);

    (f) irrevocable standby letters of credit having the character of credit substitutes;

    (g) assets purchased under outright forward purchase agreements;

    (h) forward deposits;

    (i) the unpaid portion of partly-paid shares and securities;

    (j) asset sale and repurchase agreements–

        (i) including agreements where the transferee is merely entitled to return the assets at the purchase price or for a different amount agreed in advance on a date specified or to be specified, the transaction in question must be deemed to be a sale with an option to purchase; and

        (ii) excluding agreements where the transferor is not entitled to show in his balance sheets the assets transferred;

    (k) other items also carrying full risk.

2. Medium risk–

    (a) trade finance off-balance sheet items, namely documentary credits issued or confirmed (see also ‘ Medium/low risk ’);

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(b) other off-balance sheet items–

(i) shipping guarantees, customs and tax bonds;

(ii) undrawn credit facilities (agreements to lend, purchase securities, provide guarantees or acceptance facilities) with an original maturity of more than one year;

(iii) note issuance facilities (NIFs) and revolving underwriting facilities (RUFs);

(iv) other items also carrying medium risk and as communicated to the GFSC.

3. Medium/low risk–

(a) trade finance off-balance sheet items–

(i) documentary credits in which underlying shipment acts as collateral and other self-liquidating transactions;

(ii) warranties (including tender and performance bonds and associated advance payment and retention guarantees) and guarantees not having the character of credit substitutes;

(iii) irrevocable standby letters of credit not having the character of credit substitutes;

(b) other off-balance sheet items–

(i) undrawn credit facilities which comprise agreements to lend, purchase securities, provide guarantees or acceptance facilities with an original maturity of up to and including one year which may not be cancelled unconditionally at any time without notice or that do not effectively provide for automatic cancellation due to deterioration in a borrower's creditworthiness;

(ii) other items also carrying medium/low risk and as communicated to the GFSC.

4. Low risk–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) undrawn credit facilities comprising agreements to lend, purchase securities, provide guarantees or acceptance facilities which may be cancelled unconditionally at any time without notice, or that do effectively provide for automatic cancellation due to deterioration in a borrower's creditworthiness. Retail credit lines may be considered as unconditionally cancellable if the terms permit the institution to cancel them to the full extent allowable under consumer protection and related legislation;

(b) undrawn credit facilities for tender and performance guarantees which may be cancelled unconditionally at any time without notice, or that do effectively provide for automatic cancellation due to deterioration in a borrower's creditworthiness; and

(c) other items also carrying low risk and as communicated to the GFSC.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

SCHEDULE 2
TYPES OF DERIVATIVES

1. Interest-rate contracts–

(a) single-currency interest rate swaps;

(b) basis-swaps;

(c) forward rate agreements;

(d) interest-rate futures;

(e) interest-rate options;

(f) other contracts of similar nature.

2. Foreign-exchange contracts and contracts concerning gold–

(a) cross-currency interest-rate swaps;

(b) forward foreign-exchange contracts;

(c) currency futures;

(d) currency options;

(e) other contracts of a similar nature;

(f) contracts of a nature similar to (a) to (e) concerning gold.

3. Contracts of a nature similar to those in paragraphs 1(a) to (e) and 2(a) to (d) of this Schedule concerning other reference items or indices. This includes as a minimum all instruments specified in paragraphs 46(4) to (7) and (9) to (11) of Schedule 2 to the Act not otherwise included in paragraphs 1 or 2 of this Schedule.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

SCHEDULE 3
ITEMS SUBJECT TO SUPPLEMENTARY REPORTING OF LIQUID ASSETS

1. Cash.

2. Central bank exposures, to the extent that these exposures can be drawn down in times of stress.

3. Transferable securities representing claims on or claims guaranteed by sovereigns, central banks, non-central government public sector entities, regions with fiscal autonomy to raise and collect taxes and local authorities, the Bank for International Settlements, the International Monetary Fund, the European Union, the European Financial Stability Facility, the European Stability Mechanism or multilateral development banks and satisfying all of the following conditions–

(a) they are assigned a 0% risk-weight under Chapter 2, Title 2 of Part 3;

(b) they are not an obligation of an institution or investment firm or any of its affiliated entities.

4. Transferable securities other than those referred to in paragraph 3 representing claims on or claims guaranteed by sovereigns or central banks issued in domestic currencies by the sovereign or central bank in the currency and country in which the liquidity risk is being taken or issued in foreign currencies, to the extent that holding of such debt matches the liquidity needs of the bank's operations in that third country.

5. Transferable securities representing claims on or claims guaranteed by sovereigns, central banks, non-central government public sector entities, regions with fiscal autonomy to raise and collect taxes and local authorities, or multilateral development banks and satisfying all of the following conditions–

(a) they are assigned a 20% risk-weight under Chapter 2, Title 2 of Part 3;

(b) they are not an obligation of an institution or investment firm or any of its affiliated entities.

6. Transferable securities other than those referred to in paragraphs 3, 4 and 5 that qualify for a 20% or better risk weight under Chapter 2, Title 2 of Part 3 or are internally rated as having an equivalent credit quality, and fulfil any of the following conditions–

(a) they do not represent a claim on an SSPE, an institution or investment firm or any of its affiliated entities;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(b) they are bonds eligible for the treatment set out in Article 129(4) or (5);

(c) they are CRR covered bonds other than those referred to in sub-paragraph (b).

7. Transferable securities other than those referred to in paragraphs 3 to 6 that qualify for a 50% or better risk weight under Chapter 2 of Title 2 of Part 3 or are internally rated as having an equivalent credit quality, and do not represent a claim on an SSPE, an institution or investment firm or any of its affiliated entities.

8. Transferable securities other than those referred to in paragraphs 3 to 7 that are collateralised by assets that qualify for a 35% or better risk weight under Chapter 2, Title 2 of Part 3 or are internally rated as having an equivalent credit quality, and are fully and completely secured by mortgages on residential property in accordance with Article 125.

9. Standby credit facilities granted by central banks within the scope of monetary policy to the extent that these facilities are not collateralised by liquid assets and excluding emergency liquidity assistance.

10. Legal or statutory minimum deposits with the central credit institution and other statutory or contractually available liquid funding from the central credit institution or institutions that are members of an institutional protection scheme or eligible for the waiver provided in Article 10, to the extent that this funding is not collateralised by liquid assets, if the credit institution belongs to an institutional protection scheme in accordance with legal or statutory provisions.

11. Exchange traded, centrally cleared common equity shares that are a constituent of a major stock index, denominated in sterling and not issued by an institution or investment firm or any of its affiliates.

12. Gold listed on a recognised exchange, held on an allocated basis.

All items with the exception of those referred to in paragraphs 1, 2 and 9 must satisfy all of the following conditions–

(a) they are traded in simple repurchase agreements or cash markets characterised by a low level of concentration;

(b) they have a proven record as a reliable source of liquidity by either repurchase agreement or sale even during stressed market conditions;

(c) they are unencumbered.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

SCHEDULE 4
SUPPLEMENTARY TECHNICAL STANDARDS

INDEX

PART 1
SUPPLEMENTARY REQUIREMENTS WITH REGARD TO OWN FUNDS

CHAPTER 1
PRRELIMINARY

1. Introduction.

CHAPTER 2
ELEMENTS OF OWN FUNDS

Foreseeable dividends and charges

2. Article 26(2)(b): meaning of “foreseeable” in foreseeable dividend.
3. Article 26(2)(b): meaning of “foreseeable” in foreseeable charge.

Cooperative societies, savings institutions, mutuals and similar institutions

4. Article 27(1)(a)(ii): type of undertaking recognised as a co-operative society.
5. Article 27(1)(a)(iii): type of undertaking recognised as a savings institution.
6. Article 27(1)(a)(i): type of undertaking recognised as a mutual.
7. Article 27(1)(a)(iv): type of undertaking recognised as a similar institution.
8. Multiple distributions constituting a disproportionate drag on own funds.
9. Preferential distributions regarding preferential rights to payments of distributions.
10. Calculation of the payout ratio for the purpose of paragraph 9(8)(b).
11. Preferential distributions regarding the order of distribution payments.

Indirect funding

12. Articles 28(1)(b), 52(1)(c) and 63(c): indirect funding of capital instruments.
13. Articles 28(1)(b), 52(1)(c) and 63(c): applicable forms and nature of indirect funding of capital instruments.

Limitations on redemption of capital instruments

14. Limitations on redemption of capital instruments issued by mutuals, savings institutions, co-operatives societies and similar institutions.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

15. Limitations on redemption of capital instruments issued by mutuals, etc.; further requirements.

Prudential Filters

16. Article 32(1)(a): the concept of gain on sale.

Deductions from Common Equity Tier 1 items

17. Article 36(1)(b): deduction of losses for the current financial year.
18. Article 36(1)(c): deductions of deferred tax assets that rely on future profitability.
19. Articles 36(1)(e) and 41(1)(b): deduction of defined benefit pension fund assets.
20. Article 36(1)(f), (h) and (i): indirect holdings.
21. Article 36(1)(f), (h) and (i): synthetic holdings,
22. Article 36(1)(f), (h) and (i): calculation of indirect holdings.
23. Article 36(1)(f), (h) and (i): default approach for calculating indirect holdings.
24. Article 36(1)(f), (h) and (i): structure-based approach for calculating indirect holdings.
25. Article 36(1)(f), (h) and (i): calculation of synthetic holdings.
26. Article 36(1)(i): calculation of significant investments.
27. Holdings of Additional Tier 1 and Tier 2.
28. Order and maximum amount of deductions of indirect holdings of own funds instruments of financial sector entities.
29. Goodwill.
30. Articles 36(1)(l) and 56(f): deductions of foreseeable tax charges.

Other deductions for Common Equity Tier 1, additional Tier 1 and Tier 2 items

31. Other deductions for capital instruments of financial institutions.
32. Capital instruments of third country insurance and reinsurance undertakings.
33. Capital instruments of undertakings excluded from Solvency 2.

CHAPTER 3
ADDITIONAL TIER 1 AND TIER 2 CAPITAL

Form and nature of incentives to redeem

34. Articles 52(1)(g) and 63(h): form and nature of incentives to redeem.

Conversion or write-down of the principal amount

35. Articles 52(1)(n) and 52(2)(c)(ii): nature of write-up of principal amount following a write-down.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

36. Article 52(1)(n): procedure and timing for determining trigger event has occurred.

Features of instruments that could hinder recapitalisation

37. Article 52(1)(o): features of instruments that could hinder recapitalisation.
38. Distribution on Own Funds instruments: broad market indices.

CHAPTER 4
GENERAL REQUIREMENTS

Indirect holdings arising from index holdings

39. Article 76(2): extent of conservatism required in estimates for calculating exposures used as an alternative to the underlying exposures.
40. Article 76(3): meaning of operationally burdensome.

Supervisory permission for reduction of own funds

41. Article 77: process requirements, etc. for application to reduce own funds.
42. Article 77(1): submission of application to reduce own funds.
43. Article 77(1): content of applications.
44. Article 77(1): additional information to be submitted with application for general prior permission for listed action.
45. Article 77(1): information to be submitted with application to renew a general prior permission for listed actions.
46. Article 77(1) timing of application to be submitted by institution.
47. Article 77(1): applications for redemptions, reductions and repurchases by mutuals, co-operative societies, savings institutions or similar institutions.

Temporary waiver from deduction from own funds

48. Article 79(1): temporary waiver from deduction of own funds.

CHAPTER 5
MINORITY INTEREST AND ADDITIONAL TIER 1 AND TIER 2 INSTRUMENTS ISSUED BY SUBSIDIARIES

49. Minority interests included in consolidated Common Equity Tier 1 capital.

PART 2
REQUIREMENTS SUPPLEMENTING ARTICLE 105 ON STANDARDS FOR PRUDENTIAL VALUATION

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

CHAPTER 1
GENERAL PROVISIONS

50. Methodology for calculating additional valuation adjustments (AVAs).
51. Interpretation.
52. Sources of market data.

CHAPTER 2
SIMPLIFIED APPROACH FOR THE DETERMINATION OF AVAs

53. Conditions for use of the simplified approach.
54. Determination of AVAs under simplified approach.
55. Determination of total AVAs calculated under simplified approach.

CHAPTER 3
CORE APPROACH FOR THE DETERMINATION OF AVAs

56. Overview of the core approach.
57. General provisions for the calculations of AVAs under core approach.
58. Calculation of market price uncertainty AVA.
59. Calculation of close-out costs AVA.
60. Calculation of model risk AVA.
61. Aggregating formulae.
62. Calculation of unearned credit spreads AVA.
63. Calculation of investing and funding costs AVA.
64. Calculation of concentrated positions AVA.
65. Calculation of future administrative costs AVA.
66. Calculation of early termination AVA.
67. Calculation of operational risk AVA.
68. Documentation requirements.
69. Systems and controls requirements.

PART 3
SUPPLEMENTARY REQUIREMENTS FOR DETERMINING OVERALL EXPOSURE TO CLIENTS OR GROUPS OF CONNECTED CLIENTS IN RESPECT OF TRANSACTIONS WITH UNDERLYING ASSETS

70. Introduction.
71. Interpretation.
72. Identification of exposures resulting from transactions.
73. Underlying exposures to transactions which have underlying assets.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

74. Calculation of the exposure value.
75. Procedure for determining contribution of underlying exposures to overall exposures.
76. Additional exposure constituted by structure of transaction.

PART 4
REQUIREMENTS SUPPLEMENTING THE LIQUIDITY COVERAGE REQUIREMENT FOR CREDIT INSTITUTIONS

TITLE 1
THE LIQUIDITY COVERAGE RATIO

77. Introduction.
78. Scope and application.
79. Interpretation.
80. The liquidity coverage ratio.
81. Stress scenarios for the purposes of the liquidity coverage ratio.

TITLE 2
THE LIQUIDITY BUFFER

CHAPTER 1
General provisions

82. Composition of the liquidity buffer.
83. .General requirements for liquid assets.
84. Operational requirements.
85. Valuation of Liquid Assets.

CHAPTER 2
Liquid Assets

86. Level 1 assets.
87. Level 2A assets.
88. Level 2B assets.
89. Level 2B securitisations.
90. Restricted-use committed liquidity facilities.
91. CIUs.
92. Composition of the liquidity buffer by asset level.
93. Breach of requirements.
94. Alternative liquidity approaches.

TITLE 3

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

LIQUIDITY OUTFLOWS AND INFLOWS

CHAPTER 1
Net Liquidity outflows

95. Definition of net liquidity outflows.
96. Netting of derivatives transactions

CHAPTER 2
Liquidity outflows

97. Definition of liquidity outflows.
98. Additional liquidity outflows for other products and services.
99. Outflows from stable retail deposits.
100. Outflows from other retail deposits.
101. Outflows with inter-dependent inflows.
102. Outflows from operational deposits.
103. Outflows from other liabilities.
104. Outflows within a group.
105. Additional outflows.
106. Outflows from credit and liquidity facilities.
107. Outflows from liabilities and commitments not covered by other provisions of this Chapter.

CHAPTER 3
Liquidity inflows

108. Inflows.
109. Cap on Inflows.
110. Inflows within a group.

TITLE 5
FINAL PROVISIONS

111. Transitional provision: Government-guaranteed bank assets.
112. Transitional provision for securitisations backed by residential loans.
113. Formulae for the determination of the liquidity buffer composition.
114. Formula for the calculation of the net liquidity outflow.

PART 5

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

REQUIREMENTS SUPPLEMENTING THE APPLICATION OF DEROGATIONS CONCERNING CURRENCIES WITH CONSTRAINTS ON THE AVAILABILITY OF LIQUID ASSETS

115. Introduction.
116. Assessment of justified needs.
117. Application of derogation in Article 419(2)(a).
118. Application of derogation in Article 419(2)(b).
119. Fee for granting a credit line.

PART 6
REQUIREMENTS SUPPLEMENTING ADDITIONAL LIQUIDITY OUTFLOWS CORRESPONDING TO COLLATERAL NEEDS RESULTING FROM ADVERSE MARKET SCENARIO IMPACTS ON DERIVATIVES TRANSACTIONS

120. Materiality of an institution's derivatives transactions.
121. Calculation of an additional outflow corresponding to collateral needs resulting from the impact of an adverse market scenario on an institution's derivative transactions.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

PART 1
SUPPLEMENTARY REQUIREMENTS WITH REGARD TO OWN FUNDS

CHAPTER 1
PRELIMINARY

Introduction.

1. This Part contains detailed requirements which supplement specific provisions relating to own funds.

CHAPTER 2
ELEMENTS OF OWN FUNDS

Foreseeable dividends and charges

Article 26(2)(b): meaning of "foreseeable" in foreseeable dividend.

2.(1) The amount of foreseeable dividends to be deducted by institutions from the interim or year-end profits as provided in Article 26(2)(b) must be determined in accordance with sub-paragraphs (2) to (4).

(2) Where an institution's management body has formally taken a decision or proposed a decision to the institution's relevant body regarding the amount of dividends to be distributed, that amount must be deducted from the corresponding interim or year-end profits.

(3) Where interim dividends are paid, the residual amount of interim profit resulting from the calculation in sub-paragraph (2) which is to be added to Common Equity Tier 1 items must be reduced, taking account of sub-paragraphs (2) and (4), by the amount of any foreseeable dividend which can be expected to be paid out from that residual interim profit with the final dividends for the full business year.

(4) Before the management body has formally taken a decision or proposed a decision to the relevant body on the distribution of dividends, the amount of foreseeable dividends to be deducted by institutions from the interim or year-end profits must equal the amount of interim or year-end profits multiplied by the dividend payout ratio.

(5) The dividend pay-out ratio must be determined on the basis of the dividend policy approved for the relevant period by the management body or other relevant body.

(6) Where the dividend policy contains a pay-out range instead of a fixed value, the upper end of the range is to be used for the purpose of sub-paragraph (2).

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(7) In the absence of an approved dividend policy, or when it is likely that the institution will not apply its dividend policy or this policy is not a prudent basis upon which to determine the amount of deduction, the dividend pay-out ratio must be based on the highest of the following–

(a) the average dividend pay-out ratio over the three years prior to the year under consideration; or

(b) the dividend pay-out ratio of the year preceding the year under consideration.

(8) Institutions may adjust the calculation of the dividend pay-out ratio as described in sub-paragraph (7)(a) and (b) of to exclude exceptional dividends if it notifies the GFSC of its intention to do so.

(9) The amount of foreseeable dividends to be deducted must be determined taking into account any regulatory restrictions on distributions, in particular restrictions determined in accordance with the regulation 94 of the CICR Regulations.

(10) The amount of profit after deduction of foreseeable charges subject to such restrictions may be included fully in Common Equity Tier 1 items where the condition in Article 26(2)(a) is met. When such restrictions are applicable, the foreseeable dividends to be deducted must be based on the capital conservation plan which has been notified to the GFSC in accordance with regulation 95 of the CICR Regulations and which the institution is implementing.

(11) The amount of foreseeable dividends to be paid in a form that does not reduce the amount of Common Equity Tier 1 items, such as dividends in the form of shares, known as scrip-dividends, must not be deducted from interim or year-end profits to be included in Common Equity Tier 1 items.

(12) All necessary deductions to the interim or year-end profits and all those related to foreseeable dividends must be made, either under the applicable accounting framework or under any other adjustments, before including the interim or year-end profits in Common Equity Tier 1 items.

Article 26(2)(b): meaning of “foreseeable” in foreseeable charge.

3.(1) The amount of foreseeable charges to be taken into account must comprise the following–

(a) the amount of taxes;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(b) the amount of any obligations or circumstances arising during the related reporting period which are likely to reduce the profits of the institution and for which the GFSC is not satisfied that all necessary value adjustments, such as additional value adjustments according to Article 34 or provisions have been made.

(2) Foreseeable charges that have not already been taken into account in the profit and loss account must be assigned to the interim period during which they have incurred so that each interim period bears a reasonable amount of these charges. Material or non-recurrent events must be considered in full and without delay in the interim period during which they arise.

(3) All necessary deductions to the interim or year-end profits and all those related to foreseeable charges must be made, either under the applicable accounting framework or under any other adjustments, before including the interim or year-end profits in Common Equity Tier 1 items.

Co-operative Societies, Savings Institutions, Mutuals and Similar Institutions

Article 27(1)(a)(ii): type of undertaking recognised as a co-operative society.

4.(1) An undertaking recognised under the applicable law of Gibraltar qualifies as a co-operative society for the purpose of Part 2 of the principal Standards, where all of the conditions in sub-paragraphs (2) to (4) are met.

(2) To qualify as a co-operative society for the purposes of sub-paragraph (1), an institution must be a registered society within the meaning of the Co-operative Societies Act.

(3) With respect to Common Equity Tier 1 capital, to qualify as a co-operative society for the purposes of sub-paragraph (1), the institution must be able to issue, under the applicable law of Gibraltar or the society’s statutes, at the level of the legal entity, only capital instruments referred to in Article 29.

(4) To qualify as a co-operative society for the purposes of sub-paragraph (1), when under the applicable law of Gibraltar, the holders of the Common Equity Tier 1 instruments referred to in sub-paragraph (3) which may be members or non-members of the institution, have the ability to resign, they may also have the right to put the capital instrument back to the institution, but only subject to the restrictions of the applicable law of Gibraltar, the statutes of the institution, the principal Standards and of this Part. This does not prevent the institution from issuing, under the applicable law of Gibraltar or of a third country, Common Equity Tier 1 instruments complying with Article 29 to members and non-members that do not grant a right to put the capital instrument back to the institution.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Article 27(1)(a)(iii): type of undertaking recognised as a savings institution.

5.(1) An undertaking recognised under the applicable law of Gibraltar qualifies as a savings institution for the purpose of Part 2 of the principal Standards and this Part, where all the conditions in sub-paragraphs (2) to (5) are met.

(2) With respect to Common Equity Tier 1 capital, to qualify as a savings institution for the purposes of sub-paragraph (1), the institution has to be able to issue, under the applicable law of Gibraltar or the statutes of the institution, at the level of the legal entity, only capital instruments referred to in Article 29.

(3) To qualify as a savings institution for the purposes of sub-paragraph (1), the sum of capital, reserves and interim or year-end profits, must not be allowed, under the applicable law of Gibraltar, to be distributed to holders of Common Equity Tier 1 instruments.

(4) That condition is to be regarded as fulfilled even where the institution issues Common Equity Tier 1 instruments that grant the holders, on a going concern basis, a right to a part of the profits and reserves, where allowed by such law, if that part is proportionate to their contribution to the capital and reserves or, where permitted by such law, in accordance with an alternative arrangement.

(5) The institution may issue Common Equity Tier 1 instruments that grant the holders, in the case of insolvency or liquidation of the institution, the right to reserves which do not need to be proportionate to the contribution to capital and reserves if the conditions in Article 29(4) and (5) are met.

Article 27(1)(a)(i): type of undertaking recognised as a mutual.

6.(1) An undertaking recognised under the applicable law of Gibraltar qualifies as a mutual for the purpose of Part 2 of the principal Standards and this Part, where all of the conditions in sub-paragraphs (2) to (5) are met.

(2) To qualify as a mutual for the purposes of sub-paragraph (1), the institution must be incorporated (or treated as being incorporated) as a building society under the law of Gibraltar.

(3) With respect to Common Equity Tier 1 capital, to qualify as a mutual for the purposes of sub-paragraph (1), the institution is only allowed to issue, under the applicable law of Gibraltar or the statutes of the institution, at the level of the legal entity, capital instruments referred to in Article 29.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(4) To qualify as a mutual for the purposes of sub-paragraph (1), the total amount or a partial amount of the sum of capital and reserves must be owned by members of the institution, who do not, in the ordinary course of business, benefit from direct distribution of the reserves, in particular through the payment of dividends.

(5) That condition is to be regarded as fulfilled even where the institution issues Common Equity Tier 1 instruments that grant a right on the profits and reserves, where allowed by the applicable law of Gibraltar.

Article 27(1)(a)(iv): type of undertaking recognised as a similar institution.

7.(1) An undertaking recognised under the applicable law of Gibraltar qualifies as a similar institution to co-operatives, mutuals and savings institutions for the purpose of Part 2 of the principal Standards and this Part, where all of the conditions in sub-paragraphs (2) and (3) are met.

(2) With respect to Common Equity Tier 1 capital, to qualify as a similar institution to co-operatives, mutuals and savings institutions for the purposes of sub-paragraph (1), the institution must be only able to issue, under the applicable law of Gibraltar or the statutes of the institution, at the level of the legal entity, capital instruments referred to in Article 29.

(3) To qualify as a similar institution to co-operatives, mutuals and savings institutions for the purposes of sub-paragraph (1), one or more of the following conditions shall also be met–

(a) where the holders, which may be members or non-members of the institution, of the Common Equity Tier 1 instruments referred to in sub-paragraph (2) have the ability to resign under the applicable law of Gibraltar, they may also have the right to put the capital instrument back to the institution, but only subject to the restrictions of that law, the statutes of the institution, the principal Standards and this Part. That does not prevent the institution from issuing, under the applicable law of Gibraltar or of a third country, Common Equity Tier 1 instruments complying with Article 29 to members and non-members that do not grant a right to put the capital instrument back to the institution;

(b) the sum of capital, reserves and interim or year-end profits, is not allowed, under the applicable law of Gibraltar, to be distributed to holders of Common Equity Tier 1 instruments. That condition is to be regarded as fulfilled even where the institution issues Common Equity Tier 1 instruments that grant the holders, on a going concern basis, a right to a part of the profits and reserves, where allowed by such law, if that part is proportionate to their contribution to the capital and reserves or, where permitted by law, in accordance with an alternative arrangement. The institution may issue Common Equity Tier 1 instruments that

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

grant the holders, in the case of insolvency or liquidation of the institution, the right to reserves which do not need to be proportionate to the contribution to capital and reserves if the conditions of Article 29(4) and (5) are met;

(c) the total amount or a partial amount of the sum of capital and reserves is owned by members of the institution who do not, in the ordinary course of business, benefit from direct distribution of the reserves, in particular through the payment of dividends.

Multiple distributions constituting a disproportionate drag on own funds.

8.(1) Distributions on Common Equity Tier 1 instruments referred to in Article 28 do not constitute a disproportionate drag on capital where all of the following conditions are met–

(a) the dividend multiple is a multiple of the distribution paid on the voting instruments and not a predetermined fixed amount;

(b) the dividend multiple is set contractually or under the statutes of the institution;

(c) the dividend multiple is not revisable;

(d) the same dividend multiple applies to all instruments with a dividend multiple;

(e) the amount of the distribution on one instrument with a dividend multiple does not represent more than 125% of the amount of the distribution on one voting Common Equity Tier 1 instrument.

As a formula this must be expressed as–

$$l \leq 1.25 \times k$$

where–

k represents the amount of the distribution on one instrument without a dividend multiple;

l represents the amount of the distribution on one instrument with a dividend multiple;

(f) the total amount of the distributions paid on all Common Equity Tier 1 instruments during a one year period does not exceed 105% of the amount that would have

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

been paid if instruments with fewer or no voting rights received the same distributions as voting instruments.

As a formula this must be expressed as–

$$kX + lY \leq (1.05) \times k \times (X + Y)$$

where–

k represents the amount of the distribution on one instrument without a dividend multiple;

l represents the amount of the distribution on one instrument with a dividend multiple;

X represents the number of voting instruments;

Y represents the number of non-voting instruments.

The formula must be applied on a one-year basis.

(2) Where the condition in sub-paragraph (1)(f) is not met, only the amount of the instruments with a dividend multiple that exceeds the specified threshold are to be regarded as causing a disproportionate drag on capital.

(3) Where any of the conditions in sub-paragraph (1)(a) to (e) are not met, all outstanding instruments with a dividend multiple are to be regarded as causing a disproportionate drag on capital.

Preferential distributions regarding preferential rights to payments of distributions.

9.(1) For Common Equity Tier 1 instruments referred to in Article 28, a distribution on a Common Equity Tier 1 instrument is to be regarded as preferential relative to other Common Equity Tier 1 instruments where there are differentiated levels of distributions, unless the conditions in paragraph 8 are met.

(2) For Common Equity Tier 1 instruments with fewer or no voting rights issued by institutions referred to in Article 27, where distribution is a multiple of the distribution on the voting instruments and that multiple distribution is set contractually or statutorily, distributions are not to be regarded as preferential where all of the following conditions are met–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) the dividend multiple is a multiple of the distribution paid on the voting instruments and not a predetermined fixed amount;

(b) the dividend multiple is set contractually or under the statutes of the institution;

(c) the dividend multiple is not revisable;

(d) the same dividend multiple applies to all instruments with a dividend multiple;

(e) the amount of the distribution on one instrument with a dividend multiple does not represent more than 125% of the amount of the distribution on one voting Common Equity Tier 1 instrument.

As a formula this may be expressed as–

$$l \leq 1.25 \times k$$

where–

k represents the amount of the distribution on one instrument without a dividend multiple;

l represents the amount of the distribution on one instrument with a dividend multiple;

(f) the total amount of the distributions paid on all Common Equity Tier 1 instruments during a one year period does not exceed 105% of the amount that would have been paid if instruments with fewer or no voting rights received the same distributions as voting instruments.

As a formula this may be expressed as–

$$kX + lY \leq (1.05) \times k \times (X + Y)$$

where–

k represents the amount of the distribution on one instrument without a dividend multiple;

l represents the amount of the distribution on one instrument with a dividend multiple;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

X represents the number of voting instruments;

Y represents the number of non-voting instruments;

The formula must be applied on a one-year basis.

(3) Where the condition in sub-paragraph (2)(f) is not met, only the amount of the instruments with a dividend multiple that exceeds the threshold defined therein must be disqualified from Common Equity Tier 1.

(4) Where any of the conditions in sub-paragraph (2)(a) to (e) are not met, all outstanding instruments with a dividend multiple must be disqualified from Common Equity Tier 1 capital.

(5) For the purposes of sub-paragraph (2), where the distributions of Common Equity Tier 1 instruments are expressed, for the voting or the non-voting instruments, with reference to the purchase price at issuance of the instrument, the formulas must be adapted as follows, for the instrument or instruments that are expressed with reference to the purchase price at issuance–

(a) l represents the amount of the distribution on one instrument without a dividend multiple divided by the purchase price at issuance of that instrument;

(b) k represents the amount of the distribution on one instrument with a dividend multiple divided by the purchase price at issuance of that instrument.

(6) For Common Equity Tier 1 instruments with fewer or no voting rights issued by institutions referred to in Article 27, where the distribution is not a multiple of the distribution on the voting instruments, distributions must not to be regarded as preferential where either of the conditions in sub-paragraph (7) and both of the conditions in sub-paragraph (8) are met.

(7) For the purposes of sub-paragraph (6), either of the following conditions must apply–

(a) both of the following are met–

(i) the instrument with fewer or no voting rights can only be subscribed and held by the holders of voting instruments; and

`(ii) the number of the voting rights of any single holder is limited;

(b) the distributions on the voting instruments issued by the institutions are subject to a cap set out under the applicable law of Gibraltar or a third country.

(8) For the purposes of sub-paragraph (6), both of the following conditions must apply–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) the institution demonstrates that the average of the distributions on voting instruments during the preceding five years, is low in relation to other comparable instruments;

(b) the institution demonstrates that the payout ratio is low, where a payout ratio is calculated in accordance with paragraph 10. A payout ratio under 30% must be regarded as low.

(9) For the purposes of sub-paragraph (7)(a), the voting rights of any single holder must be regarded as limited in the following cases–

(a) where each holder only receives one voting right irrespective of the number of voting instruments for any holder;

(b) where the number of voting rights is capped irrespective of the number of voting instruments held by any holder;

(c) where the number of voting instruments any holder may hold is limited under the statutes of the institution or under the applicable law of Gibraltar, or of a third country.

(10) For the purposes of this paragraph, the one year period must be deemed to end on the date of the last financial statements of the institution.

(11) Institutions must assess compliance with the conditions referred to in sub-paragraphs (7) and (8), and inform the GFSC about the result of the assessment, at least in the following situations–

(a) every time a decision on the amount of distributions on Common Equity Tier 1 instruments is taken;

(b) every time a new class of Common Equity Tier 1 instruments with fewer or no voting rights is issued.

(12) Where the condition in sub-paragraph (8)(b) is not met, only the amount of the non-voting instruments for which distributions exceed the defined threshold may be considered to entail preferential distributions.

(13) Where the condition in sub-paragraph (8)(a) is not met, the distributions on all outstanding non-voting instruments must be considered to be preferential unless they meet the conditions in sub-paragraph (2).

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(14) Where neither of the conditions in sub-paragraph (7) are met, the distributions on all outstanding non-voting instruments must be considered to be preferential unless they meet the conditions in sub-paragraph (2).

(15) The requirement in either or both of sub-paragraphs (7)(a)(i) and (8)(b) need not be met where both of the following conditions are met–

(a) an institution is in breach of or, due, inter alia, to a rapidly deteriorating financial condition, is likely in the near future to be in breach of any of the requirements;

(b) the GFSC has required the institution to urgently increase its Common Equity Tier 1 capital within a specified period and has assessed that the institution is not able to rectify or avoid the breach referred to in paragraph (a) within that specified period, without resorting to the waiver referred to in this paragraph.

Calculation of the payout ratio for the purpose of paragraph 9(8)(b).

10.(1) For the purposes of paragraph 9(8)(b), institutions must calculate the payout ratio as the sum of distributions related to total Common Equity Tier 1 instruments over the previous five year periods, divided by the sum of profits related to the previous five year periods.

(2) For the purposes of sub-paragraph (1), profits mean the amount reported in row 670 of template 2 of Annex III to Regulation (EU) No 680/2014 or where applicable, the amount reported in row 670 of template 2 of Annex IV to that Regulation with regard to supervisory reporting of institutions according to the principal Standards.

Preferential distributions regarding the order of distribution payments.

11.(1) For the purposes of Article 28, a distribution on a Common Equity Tier 1 instrument must be regarded as preferential relative to other Common Equity Tier 1 instruments and regarding the order of distribution payments where at least one of the following conditions is met–

(a) distributions are decided at different times;

(b) distributions are paid at different times;

(c) there is an obligation on the issuer to pay the distributions on one type of Common Equity Tier 1 instruments before paying the distributions on another type of Common Equity Tier 1 instruments;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(d) a distribution is paid on some Common Equity Tier 1 instruments but not on others (unless the condition in paragraph 9(7)(a) is met).

Indirect Funding

Articles 28(1)(b), 52(1)(c) and 63(c): indirect funding of capital instruments.

12.(1) Indirect funding of capital instruments under Article 28(1)(b), Article 52(1)(c) and Article 63(c) must be regard as funding that is not direct.

(2) For the purposes of sub-paragraph (1), direct funding refers to situations where an institution has granted a loan or other funding in any form to an investor that is used for the acquisition of ownership of its capital instruments.

(3) Direct funding also includes funding granted for other purposes than acquisition of ownership of an institution's capital instruments, to any person who has a qualifying holding in the credit institution, or who is considered to be a related party within the meaning of the definitions in paragraph 9 of International Accounting Standard 24 on Related Party Disclosures as applied under UK-adopted international accounting standards, if the institution is not able to demonstrate all of the following–

(a) the transaction is realised at similar conditions as other transactions with third parties;

(b) the person or the related party does not have to rely on the distributions or on the sale of the capital instruments held to support the payment of interest and the repayment of the funding.

Articles 28(1)(b), 52(1)(c) and 63(c): applicable forms and nature of indirect funding of capital instruments.

13.(1) The applicable forms and nature of indirect funding of the acquisition of ownership of an institution's capital instruments include the following–

(a) funding of an investor's purchase, at issuance or thereafter, of an institution's capital instruments by any entities on which the institution has a direct or indirect control or by entities included in any of the following–

(i) the scope of accounting or prudential consolidation of the institution;

(ii) the scope of supplementary supervision of the institution in accordance with the Financial Services (Financial Conglomerates) Regulations 2020;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(b) funding of an investor's acquisition of ownership, at or after issuance, of an institution's capital instruments by external entities that are protected by a guarantee or by the use of a credit derivative or are secured in some other way so that the credit risk is transferred to the institution or to any entities on which the institution has a direct or indirect control or any entities included in any of the following–

(i) the scope of accounting or prudential consolidation of the institution;

(ii) the scope of supplementary supervision of the institution in accordance with the Financial Services (Financial Conglomerates) Regulations 2020;

(c) funding of a borrower that passes the funding on to the ultimate investor for the acquisition of ownership, at or after issuance, of an institution's capital instruments.

(2) In order to be considered as indirect funding for the purposes of sub-paragraph (1), the following conditions must also be met, where applicable–

(a) the investor is not included in any of the following–

(i) the scope of accounting or prudential consolidation of the institution;

(ii) the scope of the supplementary supervision of the institution in accordance with the Financial Services (Financial Conglomerates) Regulations 2020;

(b) the external entity is not included in any of the following–

(i) the scope of accounting or prudential consolidation of the institution;

(ii) the scope of the supplementary supervision of the institution in accordance with the Financial Services (Financial Conglomerates) Regulations 2020;

(3) When establishing whether the acquisition of ownership of a capital instrument involves direct or indirect funding in accordance with paragraph 12, the amount to be considered must be net of any individually assessed impairment allowance made.

(4) In order to avoid a qualification of direct or indirect funding in accordance with paragraph 12, and where the loan or other form of funding or guarantees is granted to any person who has a qualifying holding in the institution or who is considered to be a related party as referred to in paragraph 12(3), the institution must ensure on an on-going basis that it has not provided

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

the loan or other form of funding or guarantees for the purpose of acquiring ownership directly or indirectly of capital instruments of the institution. Where the loan or other form of funding or guarantees is granted to other types of parties, the institution must make this control on a best effort basis.

(5) With regard to mutuals, co-operative societies and similar institutions, where there is an obligation under the law of Gibraltar or the statutes of the institution for a customer to acquire ownership of capital instruments in order to receive a loan, that loan must not be considered to be a direct or indirect funding where all of the following conditions are met–

(a) the amount of the subscription is considered immaterial by the GFSC;

(b) the purpose of the loan is not the acquisition of ownership of capital instruments of the institution providing the loan;

(c) the subscription of one or more capital instruments of the institution is necessary in order for the beneficiary of the loan to become a member of the mutual, co-operative society or similar institution.

Limitations on redemption of capital instruments

Limitations on redemption of capital instruments issued by mutuals, savings institutions, co-operatives societies and similar institutions.

14.(1) An institution may issue Common Equity Tier 1 instruments with a possibility to redeem only where such redemption is permitted under the applicable law of Gibraltar or a third country.

(2) The ability of the institution to limit the redemption under the provisions governing capital instruments as referred to in paragraph 42(2)(b) encompasses both the right to defer the redemption and the right to limit the amount to be redeemed. The institution may defer the redemption or limit the amount to be redeemed for an unlimited period of time pursuant to sub-paragraph (3).

(3) The extent of the limitations on redemption included in the provisions governing the instruments must be determined by the institution on the basis of the prudential situation of the institution at any time, having regard to in particular, but not limited to–

(a) the overall financial, liquidity and solvency situation of the institution;

(b) the amount of Common Equity Tier 1 capital, Tier 1 and total capital compared to the total risk exposure amount calculated in accordance with the requirements in

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Article 92(1)(a), the additional own funds requirements in regulation 104A of the CICR Regulations and the combined buffer as defined in regulation 82 of those Regulations.

Limitations on redemption of capital instruments issued by mutuals, etc.: further requirements.

15.(1) Where instruments are governed by the applicable law of Gibraltar or of a third country in the absence of contractual provisions, the institution must ensure that the law allows the institution to limit redemption as referred to in paragraph 14(1) to (3) in order for the instruments to qualify as Common Equity Tier 1.

(2) Any decision to limit redemption must be documented internally and reported in writing by the institution to the GFSC, including the reasons why, in view of the criteria set out in paragraph 14(3), a redemption has been partially or fully refused or deferred.

(3) Where several decisions to limit redemption are taking place in the same period of time, institutions may document these decisions in a single set of documents.

Prudential Filters

Article 32(1)(a): the concept of gain on sale.

16.(1) The concept of gain on sale referred to in Article 32(1)(a) means any recognised gain on sale for the institution that is recorded as an increase in any element of own funds and is associated with future margin income arising from a sale of securitised assets when they are removed from the institution's balance sheet in the context of a securitisation transaction.

(2) The recognised gain on sale must be determined. by applying the relevant accounting framework, as the difference between–

(a) the net value of the assets received including any new asset obtained less any other asset given or any new liability assumed; and

(b) the carrying amount of the securitised assets or of the part derecognised.

(3) The recognised gain on sale which is associated with the future margin income refers, in this context, to the expected future "excess spread" as defined in Article 242.

Deductions from Common Equity Tier 1 Items

Article 36(1)(b): deduction of losses for the current financial year.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

17.(1) For the purpose of calculating its Common Equity Tier 1 capital during the year, and irrespective of whether the institution closes its financial accounts at the end of each interim period, the institution must determine its profit and loss accounts and deduct any resulting losses from Common Equity Tier 1 items as they arise.

(2) For the purpose of determining an institution's profit and loss accounts in accordance with sub-paragraph (1), income and expenses must be determined under the same process and on the basis of the same accounting standards as the one followed for the year-end financial report.

Income and expenses must be prudently estimated and assigned to the interim period in which they incurred so that each interim period bears a reasonable amount of the anticipated annual income and expenses.

Material or non-recurrent events must be considered in full and without delay in the interim period during which they arise.

(3) Where losses for the current financial year have already reduced Common Equity Tier 1 items as a result of an interim or a year-end financial report, a deduction is not needed.

For the purpose of this paragraph, the financial report means that the profit and losses have been determined after a closing of the interim or the annual accounts in accordance with the applicable accounting framework.

(4) Sub-paragraphs (1) to (3) apply in the same manner to gains and losses included in accumulated other comprehensive income.

Article 36(1)(c): deductions of deferred tax assets that rely on future profitability.

18.(1) The deductions of deferred tax assets that rely on future profitability under Article 36(1)(c) must be made in accordance with sub-paragraphs (2) and (3).

(2) The offsetting between deferred tax assets and associated deferred tax liabilities must be done separately for each taxable entity. Associated deferred tax liabilities must be limited to those that arise from the tax law of the same jurisdiction as the deferred tax assets.

For the calculation of deferred tax assets and liabilities at consolidated level, a taxable entity includes any number of entities which are members of the same tax group, fiscal consolidation, fiscal unity or consolidated tax return under the applicable law of Gibraltar or a third country.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(3) The amount of associated deferred tax liabilities which are eligible for offsetting deferred tax assets that rely on future profitability is equal to the difference between–

(a) the amount of deferred tax liabilities as recognised under the applicable accounting framework; and

(b) the amount of associated deferred tax liabilities arising from intangible assets and from defined benefit pension fund assets.

Articles 36(1)(e) and 41(1)(b): deduction of defined benefit pension fund assets.

19.(1) For the purposes of an application for permission under Article 41(1)(b), the unrestricted ability to use the respective defined benefit pension fund assets entails immediate and unfettered access to the assets such as when the use of the assets is not barred by a restriction of any kind and there are no claims of any kind from third parties on these assets.

(2) Unfettered access to the assets is likely to exist when the institution is not required to request and receive specific approval from the manager of the pension funds or the pension beneficiaries each time it would access excess funds in the plan.

Article 36(1)(f), (h) and (i): indirect holdings.

20.(1) For the purposes of paragraphs 22, 23, 24 and 28, an "intermediate entity" within the meaning of Article 4 comprises any of the following entities that hold capital instruments of financial sector entities–

(a) a collective investment undertaking;

(b) a pension fund other than a defined benefit pension fund;

(c) a defined benefit pension fund, where the institution is supporting the investment risk and where the defined benefit pension fund is not independent from its sponsoring institution;

(d) entities that are directly or indirectly under the control or under significant influence of one of the following–

(i) the institution or its subsidiaries;

(ii) the parent undertaking of the institution or the subsidiaries of that parent undertaking;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(iii) the parent financial holding company of the institution or the subsidiaries of that parent financial holding company;

(iv) the parent mixed activity holding company of the institution or the subsidiaries of the parent mixed activity holding company;

(v) the parent mixed financial holding company of the institution or the subsidiaries of the parent mixed financial holding company;

(e) entities that are jointly, directly or indirectly, under the control or under significant influence of one institution, several institutions, or a network of institutions, which are members of the same institutional protection scheme, or of the institutional protection scheme or the network of institutions affiliated to a central body that are not organised as a group to which the institution belongs;

(f) special purpose entities;

(g) entities whose activity is to hold financial instruments of financial sector entities;

(h) any other entity that is used with the intention of circumventing the rules relating to the deduction of indirect and synthetic holdings.

(2) Without limiting sub-paragraph (1)(h), an intermediate entity does not comprise–

(a) mixed activity holding companies, institutions, insurance undertakings, reinsurance undertakings;

(b) entities that are, by virtue of the applicable law of Gibraltar, subject to the requirements of these Standards and the CICR Regulations;

(c) financial sector entities other than the ones mentioned in paragraph (a), which are supervised and required to deduct direct and indirect holdings of their own capital instruments and holdings of capital instruments of financial sector entities from their regulatory capital.

(3) For the purposes of sub-paragraph (1)(c), a defined benefit pension fund is to be regarded as independent from its sponsoring institution where all of the following conditions are met–

(a) the defined benefit pension fund is legally separate from the sponsoring institution and its governance is independent;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(b) the statutes, the instruments of incorporation and the internal rules of the specific pension fund, as applicable, have been approved by an independent regulator; or the rules governing the incorporation and functioning of the defined benefit pension fund, as applicable, are established in the applicable law of the relevant jurisdiction;

(c) the trustees or administrators of the defined pension fund have an obligation under applicable national law to act impartially in the best interests of the scheme beneficiaries, rather than those of the sponsor, to manage assets of the defined pension fund prudently and to conform to the restrictions set out in the statutes, the instruments of incorporation and the internal rules of the specific pension fund, as applicable, or statutory or regulatory framework described in paragraph (b);

(d) the statutes or the instruments of incorporation or the rules governing the incorporation and functioning of the defined benefit pension fund referred to in paragraph (b) include restrictions on investments that the defined pension scheme can make in own funds instruments issued by the sponsoring institution.

(4) Where a defined benefit pension fund referred to in sub-paragraph (1)(c) holds own funds instruments of the sponsoring institution–

(a) the sponsoring institution must treat that holding as an indirect holding of own Common Equity Tier 1 instruments, own Additional Tier 1 instruments or own Tier 2 instruments (as applicable); and

(b) the amount to be deducted from the Common Equity Tier 1 items, Additional Tier 1 items or Tier 2 items (as applicable) of the sponsoring institution, must be calculated in accordance with paragraph 22.

Article 36(1)(f), (h) and (i): synthetic holdings.

21.(1) The following financial products must be considered synthetic holdings of capital instruments pursuant to Article 36(1)(f), (h) and (i)–

(a) derivative instruments that have capital instruments of a financial sector entity as their underlying or have the financial sector entity as their reference entity;

(b) guarantees or credit protection provided to a third party in respect of the third party's investments in a capital instrument of a financial sector entity.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(2) The financial products provided for in sub-paragraph (1) must include the following–

(a) investments in total return swaps on a capital instrument of a financial sector entity;

(b) call options purchased by the institution on a capital instrument of a financial sector entity;

(c) put options sold by the institution on a capital instrument of a financial sector entity or any other actual or contingent contractual obligation of the institution to purchase its own funds instruments;

(d) investments in forward purchase agreements on a capital instrument of a financial sector entity.

Article 36(1)(f), (h) and (i): calculation of indirect holdings.

22. The amount of indirect holdings to be deducted from Common Equity Tier 1 items as required in Article 36(1)(f), (h) and (i) must be calculated in one of the following ways–

(a) according to the default approach set out in paragraph 23;

(b) with the permission of the GFSC, and subject to the institution demonstrating that the approach used in paragraph 23 is excessively burdensome, according to the structure-based approach described in paragraph 24,

but the structure-based approach described in that paragraph must not be used by institutions for calculating the amount of those deductions in relation to investments in intermediate entities referred to in paragraph 20(1)(d) and (e).

Article 36(1)(f), (h) and (i): default approach for calculating indirect holdings.

23.(1) The amount of indirect holdings of Common Equity Tier 1 instruments to be deducted as required by Article 36(1)(f), (h) and (i) must be calculated as follows–

(a) where the exposures of all investors to the intermediate entity rank *pari passu*, the amount shall be equal to the percentage of funding multiplied by the amount of Common Equity Tier 1 instruments of the financial sector entity held by the intermediate entity;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(b) where the exposures of all investors to the intermediate entity do not rank *pari passu*, the amount must be equal to the percentage of funding multiplied with the lower of the following amounts–

(i) the amount of Common Equity Tier 1 instruments of the financial sector entity held by the intermediate entity;

(ii) the institution's exposure to the intermediate entity together with all other funding provided to the intermediate entity that rank *pari passu* with the institution's exposure.

(2) The calculation method set out in sub-paragraph (1)(b) applies for each tranche of funding that ranks *pari passu* with the funding provided by the institution.

(3) The percentage of funding for the purposes of sub-paragraph (1) must be the institution's exposure to the intermediate entity divided by the sum of the institution's exposure to the intermediate entity and of all other exposures to this intermediate entity that rank *pari passu* with the institution's exposure.

(4) The calculation in sub-paragraph (1) must be made separately for each holding in a financial sector entity held by each intermediate entity.

(5) Where investments in Common Equity Tier 1 instruments of a financial sector entity are held indirectly through subsequent or several intermediate entities, the percentage of funding set out in sub-paragraph (1) must be determined by dividing the amount referred to in paragraph (a) by the amount in paragraph (b)–

(a) the result of the multiplication of amounts of funding provided by the institution to intermediate entities, by the amounts of funding provided by these intermediate entities to subsequent intermediate entities, and by amounts of funding provided by these subsequent intermediate entities to the financial sector entity;

(b) the result of the multiplication of amounts of capital instruments or other instruments as relevant, issued by each intermediate entity.

(6) The percentage of funding referred to in sub-paragraph (5) must be calculated separately for each holding in a financial sector entity held by intermediate entities and for each tranche of funding that ranks *pari passu* with the funding provided by the institution and the subsequent intermediate entities.

Article 36(1)(f), (h) and (i): structure-based approach for calculating indirect holdings.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

24.(1) The amount to be deducted from Common Equity Tier 1 items referred to in paragraph Article 36(1)(f) must be equal to the percentage of funding, as defined in paragraph 23(3), multiplied by the amount of Common Equity Tier 1 instruments of the institution held by the intermediate entity.

(2) The amount to be deducted from Common Equity Tier 1 items referred to Article 36(1)(h) and (i) must be equal to the percentage of funding, as defined in paragraph 23(3), multiplied by the aggregate amount of Common Equity Tier 1 instruments of financial sector entities held by the intermediate entity.

(3) For the purposes of sub-paragraphs (1) and (2), an institution must calculate separately for each intermediate entity the aggregate amount of Common Equity Tier 1 instruments of the institution that the intermediate entity holds and the aggregate amount of Common Equity Tier 1 instruments of other financial sector entities that the intermediate entity holds.

(4) The institution must consider the amount of holdings in Common Equity Tier 1 instruments of financial sector entities calculated in accordance with sub-paragraph (2) as a significant investment referred to in Article 43 and must deduct the amount in accordance with Article 36(1)(i).

(5) Where investments in Common Equity Tier 1 instruments are held indirectly through subsequent or several intermediate entities, paragraph 23(5) and (6) applies.

(6) Where an institution is not able to identify the aggregate amounts that the intermediate entity holds in Common Equity Tier 1 instruments of the institution or in Common Equity Tier 1 instruments of financial sector entities, the institution must estimate the amounts it cannot identify by using the maximum amounts that the intermediate entity is able to hold on the basis of its investment mandates.

(7) Where the institution is not able to determine, on the basis of the investment mandate, the maximum amount that the intermediate entity holds in Common Equity Tier 1 instruments of the institution or in Common Equity Tier 1 instruments of financial sector entities, the institution must treat the amount of funding that it holds in the intermediate entity as an investment in its own Common Equity Tier 1 instruments and must deduct them in accordance with Article 36(1)(f).

(8) Despite sub-paragraph (7), the institution must treat the amount of funding that it holds in the intermediate entity as a non-significant investment and deduct them in accordance with Article 36(1)(h), where all of the following conditions are met–

(a) the amounts of funding are less than 0.25% of the institution's Common Equity Tier 1 capital;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(b) the amounts of funding are less than GBP 8.8 million;

(c) the institution cannot reasonably determine the amounts of its own Common Equity Tier 1 instruments that the intermediate entity holds.

(9) Where funding to the intermediate entity is in the form of units or shares of a CIU, the institution may rely on the third parties referred to in Article 132(5), and under the conditions set by that Article, to calculate and report the aggregate amounts referred to in sub-paragraph (6).

Article 36(1)(f), (h) and (i): calculation of synthetic holdings.

25.(1) The amount of synthetic holdings to be deducted from Common Equity Tier 1 items as required by Article 36(1)(f), (h) and (i) is as follows–

(a) for holdings in the trading book–

(i) for options, the delta equivalent amount of the relevant instruments calculated in accordance with Title 4 of Part 3 of the principal Standards;

(ii) for any other synthetic holdings, the nominal or notional amount, as applicable;

(b) for holdings in the non-trading book–

(i) for call options, the current market value;

(ii) for any other synthetic holdings, the nominal or notional amount, as applicable.

(2) An institution must deduct the synthetic holdings referred to in sub-paragraph (1) from the date of signature of the contract between the institution and the counterparty.

Article 36(1)(i): calculation of significant investments.

26.(1) For the purposes of Article 36(1)(i), in order to assess whether an institution owns more than 10% of the Common Equity Tier 1 instruments issued by a financial sector entity, in accordance with Article 43(a), institutions must add the amounts of their gross long positions in direct holdings, as well as indirect holdings of Common Equity Tier 1 instruments of this financial sector entity referred to in paragraph 20(1)(d) to (h).

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(2) Indirect and synthetic holdings must be taken into account in order to assess whether the conditions in Article 43(b) and (c) are met.

Holdings of Additional Tier 1 and Tier 2.

27. The methodology referred to in paragraphs 20 to 25 apply mutatis mutandis to Additional Tier 1 holdings for the purposes of Article 56(a), (c) and (d) and to Tier 2 holdings for the purposes of Article 66(a), (c) and (d), where references to Common Equity Tier 1 must be read as references to Additional Tier 1 or Tier 2, as applicable.

Order and maximum amount of deductions of indirect holdings of own funds instruments of financial sector entities.

28.(1) Subject to the limits in sub-paragraphs (2) and (3), where the intermediate entity holds Common Equity Tier 1 instruments, Additional Tier 1 instruments and Tier 2 instruments of financial sector entities, the Common Equity Tier 1 instruments must be deducted first, the Additional Tier 1 instruments must be deducted second, and the Tier 2 instruments deducted last.

(2) Where the intermediate entity holds own funds instruments of institutions, when applying sub-paragraph (1) to each type of holding institutions must deduct the holdings of their own funds instruments first.

(3) Where an institution holds capital instruments of financial sector entities indirectly, the amount to be deducted from the institution's own funds must not be higher than the lower of the following amounts–

(a) the total funding provided by the institution to the intermediate entity;

(b) the amount of own funds instruments held by the intermediate entity in the financial sector entity.

Goodwill.

29. For the application of deductions referred to in Article 36(1)(h), institutions may choose not to identify goodwill separately when determining the applicable amount to be deducted according to Article 46.

Articles 36(1)(l) and 56(f): deductions of foreseeable tax charges.

30.(1) On the condition that the institution applies accounting framework and accounting policies that provide for the full recognition of current and deferred tax liabilities related to

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

transactions and other events recognised in the balance sheet or the profit and loss account, the institution may consider that foreseeable tax charges have been already taken into account.

(2) When the institution is calculating its Common Equity Tier 1 capital on the basis of financial statements prepared in accordance with UK-adopted international accounting standards, the condition in sub-paragraph (1) is to be treated as fulfilled.

(3) Where the condition in sub-paragraph (1) is not fulfilled, the institution must decrease its Common Equity Tier 1 items by the estimated amount of current and deferred tax charges not yet recognised in the balance sheet and profit and loss account related to transactions and other events recognised in the balance sheet or the profit and loss account. The estimated amount of current and deferred tax charges must be determined using an approach equivalent to the one provided by UK-adopted international accounting standards. The estimated amount of deferred tax charges may not be netted against deferred tax assets that are not recognised in the financial statements.

Other deductions for Common Equity Tier 1, Additional Tier 1 and Tier 2 items

Other deductions for capital instruments of financial institutions.

31.(1) Holdings of capital instruments of financial institutions as defined in Article 4 must be deducted according to the following calculations–

(a) all instruments qualifying as capital under the company law applicable to the financial institution that issued them and, where the financial institution is subject to solvency requirements, which are included in the highest quality Tier of regulatory own funds without any limits must be deducted from Common Equity Tier 1 items;

(b) all instruments which qualify as capital under the company law applicable to the issuer and, where the financial institution is not subject to solvency requirements, which are perpetual, absorb the first and proportionately greatest share of losses as they occur, rank below all other claims in the event of insolvency and liquidation and have no preferential or predetermined distributions must be deducted from Common Equity Tier 1 items;

(c) any subordinated instruments absorbing losses on a going-concern basis, including the discretion to cancel coupon payments, must be deducted from Additional Tier 1 items. Where the amount of these subordinated instruments exceeds the amount of Additional Tier 1 capital, the excess amount must be deducted from Common Equity Tier 1 capital;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(d) any other subordinated instruments must be deducted from Tier 2 items. If the amount of these subordinated instruments exceeds the amount of Tier 2 capital, the excess amount must be deducted from Additional Tier 1 items. Where the amount of Additional Tier 1 capital is insufficient, the remaining excess amount must be deducted from Common Equity Tier 1 items;

(e) any other instruments included in the financial institution's own funds pursuant to the relevant applicable prudential framework or any other instruments for which the institution is not able to demonstrate that the conditions in paragraphs (a) to (d) apply must be deducted from Common Equity Tier 1 items.

(2) In the cases foreseen in sub-paragraph (3), institutions must apply the deductions as foreseen by the principal Standards for holdings of capital instruments based on a corresponding deduction approach. For the purposes of this paragraph, corresponding deduction approach means an approach that applies the deduction to the same component of capital for which the capital would qualify if it was issued by the institution itself.

(3) The deductions in sub-paragraph (1) do not apply in the following cases–

(a) where the financial institution is authorised and supervised by a competent authority and subject to prudential requirements equivalent to those applied to institutions under the principal Standards. This approach must be applied to third country financial institutions only where an equivalence assessment of the prudential regime of the third country concerned has been performed under the principal Standards and where it has been concluded that the prudential regime of the third country concerned is at least equivalent to that applied in Gibraltar;

(b) where the financial institution is an authorised electronic money institution as defined in regulation 2(1) of the Financial Services (Electronic Money) Regulations 2020;

(c) where the financial institution is an authorised payment institution as defined in regulation 2(1) of the Financial Services (Payment Services) Regulations 2020;

(d) where the financial institution is a Gibraltar AIFM as defined in regulation 4(1) of the Financial Services (Alternative Investment Fund Managers) Regulations 2020 or a management company as defined in regulation 3(1) of the Financial Services (UCITS) Regulations 2020.

Capital instruments of third country insurance and reinsurance undertakings.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

32.(1) Holdings of capital instruments of third country insurance and reinsurance undertakings that are situated in a third country which either has been assessed as not equivalent to that in Part 6 of the Financial Services (Insurance Companies) Regulations 2020 according to the procedure in regulation 206 of those Regulations, or that has not been assessed, must be deducted as follows–

(a) all instruments which qualify as capital under the company law applicable to the third country insurance and reinsurance undertakings that issued them, and which are included in the highest quality Tier of regulatory own funds without any limits under the third-country regime must be deducted from Common Equity Tier 1 items;

(b) any subordinated instruments absorbing losses on a going-concern basis, including the discretion to cancel coupon payments, must be deducted from Additional Tier 1 items. Where the amount of these subordinated instruments exceeds the amount of Additional Tier 1 capital, the excess amount must be deducted from Common Equity Tier 1 items;

(c) any other subordinated instruments must be deducted from Tier 2 items. Where the amount of these subordinated instruments exceeds the amount of Tier 2 capital, the excess amount must be deducted from Additional Tier 1 items. Where this excess amount exceeds the amount of Additional Tier 1 capital, the remaining excess amount must be deducted from Common Equity Tier 1 items;

(d) for third country insurance and reinsurance undertakings that are subject to prudential solvency requirements, any other instruments included in the third country insurance and reinsurance undertakings' own funds pursuant to the relevant applicable solvency regime or any other instruments for which the institution is not able to demonstrate that paragraphs (a), (b) or (c) apply must be deducted from Common Equity Tier 1 items.

(2) Where the solvency regime of the third country including rules on own funds, has been assessed as equivalent to that in Part 6 of the Financial Services (Insurance Companies) Regulations 2020 according to the procedure in regulation 206 of those Regulations, holdings of capital instrument of the third-country insurance or reinsurance undertakings must be treated as holdings of capital instruments of in insurance or reinsurance undertakings authorised in accordance with regulation 13 of those Regulations.

(3) In the cases in sub-paragraph (2), institutions must apply the deductions in Articles 44(b), 58(b) and 68(b) as applicable, for holdings of own funds insurance items.

Capital instruments of undertakings excluded from Solvency 2.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

33. Holdings of capital instruments of undertakings which fall within sub-paragraph (k) of the definition of financial sector entity in Article 4(1) must be deducted as follows–

(a) all instruments qualifying as capital under the company law applicable to the undertaking that issued them and that are included in the highest quality Tier of regulatory own funds without any limits must be deducted from Common Equity Tier 1 capital;

(b) any subordinated instruments absorbing losses on a going-concern basis, including the discretion to cancel coupon payments, must be deducted from Additional Tier 1 items and, where the amount of these subordinated instruments exceeds the amount of Additional Tier 1 capital, the excess amount must be deducted from Common Equity Tier 1 items;

(c) any other subordinated instruments must be deducted from Tier 2 items and, if the amount of these subordinated instruments exceeds the amount of Tier 2 capital, the excess amount must be deducted from Additional Tier 1 items. Where this amount exceeds the amount of Additional Tier 1 capital, the remaining excess amount must be deducted from Common Equity Tier 1 items;

(d) any other instruments included in the undertaking's own funds pursuant to the relevant applicable solvency regime or any other instruments for which the institution is not able to demonstrate that paragraphs (a), (b) or (c) apply must be deducted from Common Equity Tier 1 capital.

CHAPTER 3
ADDITIONAL TIER 1 AND TIER 2 CAPITAL

Form and nature of incentives to redeem

Articles 52(1)(g) and 63(h): form and nature of incentives to redeem.

34.(1) Incentives to redeem mean all features that provide, at the date of issuance, an expectation that the capital instrument is likely to be redeemed.

(2) The incentives referred to in sub-paragraph (1) include the following forms–

(a) a call option combined with an increase in the credit spread of the instrument if the call is not exercised;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(b) a call option combined with a requirement or an investor option to convert the instrument into a Common Equity Tier 1 instrument where the call is not exercised;

(c) a call option combined with a change in reference rate where the credit spread over the second reference rate is greater than the initial payment rate minus the swap rate;

(d) a call option combined with an increase of the redemption amount in the future;

(e) a remarketing option combined with an increase in the credit spread of the instrument or a change in reference rate where the credit spread over the second reference rate is greater than the initial payment rate minus the swap rate where the instrument is not remarketed;

(f) a marketing of the instrument in a way which suggests to investors that the instrument will be called.

Conversion or write-down of the principal amount

Articles 52(1)(n) and 52(2)(c)(ii): nature of write-up of principal amount following a write-down.

35.(1) The write-down of the principal amount must apply on a pro-rata basis to all holders of Additional Tier 1 instruments that include a similar write-down mechanism and an identical trigger level.

(2) For the write-down to be considered temporary, all of the following conditions must be met–

(a) any distributions payable after a write-down must be based on the reduced amount of the principal;

(b) write-ups must be based on profits after the institution has taken a formal decision confirming the final profits;

(c) any write-up of the instrument or payment of coupons on the reduced amount of the principal must be operated at the full discretion of the institution subject to the constraints arising from paragraphs (d) to (f) and there must be no obligation for the institution to operate or accelerate a write-up under specific circumstances;

(d) a write-up must be operated on a pro-rata basis among similar Additional Tier 1 instruments that have been subject to a write-down;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(e) the maximum amount to be attributed to the sum of the write-up of the instrument together with the payment of coupons on the reduced amount of the principal must be equal to the profit of the institution multiplied by the amount obtained by dividing the amount determined in sub-paragraph (i) by the amount determined in sub-paragraph (ii)–

(i) the sum of the nominal amount of all Additional Tier 1 instruments of the institution before write-down that have been subject to a write-down;

(ii) the total Tier 1 capital of the institution; and

(f) the sum of any write-up amounts and payments of coupons on the reduced amount of the principal shall be treated as a payment that results in a reduction of Common Equity Tier 1 and shall be subject, together with other distributions on Common Equity Tier 1 instruments, to the restrictions relating to the Maximum Distributable Amount as referred to in provisions implementing Article 141(2) of the CRD.

(3) For the purposes of sub-paragraph (2)(e), the calculation must be made at the moment when the write-up is operated.

Article 52(1)(n): procedure and timing for determining trigger event has occurred.

36.(1) Where the institution has established that the Common Equity Tier 1 ratio has fallen below the level that activates conversion or write-down of the instrument at the level of application of the requirements in Title 1 of Part 1 of the principal Standards, the management body or any other relevant body of the institution must without delay determine that a trigger event has occurred and there is an irrevocable obligation to write-down or convert the instrument.

(2) The amount to be written-down or converted must be determined as soon as possible and within a maximum period of one month from the time it is determined that the trigger event has occurred.

(3) Where an independent review of the amount to be written down or converted is required according to the provisions governing the Additional Tier 1 instrument, or where the GFSC requires an independent review for the determination of the amount to be written down or converted, the management body or any other relevant body of the institution must see that this is done immediately. That independent review must be completed as soon as possible and must not create impediments for the institution to write-down or convert the Additional Tier 1 instrument and to meet the requirements of sub-paragraph (2).

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Features of instruments that could hinder recapitalisation

Article 52(1)(o): features of instruments that could hinder recapitalisation.

37. Features that could hinder the recapitalisation of an institution include provisions that require the institution to compensate existing holders of capital instruments where a new capital instrument is issued.

Distribution on Own Funds instruments: broad market indices.

38.(1) An interest rate index must be considered to be a broad market index if it fulfils all of the following conditions–

(a) it is used to set interbank lending rates in one or more currencies;

(b) it is used as a reference rate for floating rate debt issued by the institution in the same currency, where applicable;

(c) it is calculated as an average rate by a body independent of the institutions that are contributing to the index (a "panel");

(d) each of the rates set under the index is based on quotes submitted by a panel of institutions active in that interbank market;

(e) the composition of the panel referred to in paragraph (c) ensures a sufficient level of representativeness of institutions present in Gibraltar.

(2) For the purposes of sub-paragraph (1)(e), a sufficient level of representativeness must be considered to be achieved in either of the following cases–

(a) where the panel referred to in sub-paragraph (1)(c) includes at least 6 different contributors before any discount of quotes is applied for the purposes of setting the rate;

(b) where all of the following conditions are met–

(i) the panel referred to in in sub-paragraph (1)(c) includes at least 4 different contributors before any discount of quotes is applied for the purposes of setting the rate;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(ii) the contributors to the panel referred to in sub-paragraph (1)(c) represent at least 60% of the related market.

(3) The related market referred to in sub-paragraph (2)(b)(ii) must be the sum of assets and liabilities of the effective contributors to the panel in the domestic currency divided by the sum of assets and liabilities in the domestic currency of credit institutions in Gibraltar, including branches and money market funds in Gibraltar.

(4) A stock index must be considered to be a broad market index where it is appropriately diversified in accordance with Article 344.

CHAPTER 4
GENERAL REQUIREMENTS

Indirect holdings arising from index holdings

Article 76(2): extent of conservatism required in estimates for calculating exposures used as an alternative to the underlying exposures.

39.(1) An estimate is sufficiently conservative when either of the following conditions is met–

(a) where the investment mandate of the index specifies that an own funds instrument of a financial sector entity which is part of the index cannot exceed a maximum percentage of the index, the institution uses that percentage as an estimate for the value of the holdings that is deducted from its Common Equity Tier 1, Additional Tier 1 or Tier 2 items, as applicable in accordance with paragraph 2 of Article 17 of this Part or from Common Equity Tier 1 items in situations where the institution cannot determine the precise nature of the holding;

(b) where the institution is unable to determine the maximum percentage referred to in paragraph (a) and where the index, as evidenced by its investment mandate or other relevant information, includes own funds instruments of financial sector entities, the institution deducts the full amount of the index holdings from its Common Equity Tier 1, Additional Tier 1 or Tier 2 items, as applicable in accordance with paragraph 31(2) or from Common Equity Tier 1 items in situations where the institution cannot determine the precise nature of the holding.

(2) For the purposes of sub-paragraph (1), the following apply–

(a) an indirect holding arising from an index holding comprises the proportion of the index invested in the Common Equity Tier 1, Additional Tier 1 and Tier 2 instruments of financial sector entities included in the index;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(b) an index includes, but is not limited to, index funds, equity or bond indices or any other scheme where the underlying instrument is an own funds instrument issued by a financial sector entity.

Article 76(3): meaning of operationally burdensome.

40.(1) For the purpose of Article 76(3), operationally burdensome means situations under which look-through approaches to capital instruments holdings in financial sector entities on an ongoing basis are unjustified. In its assessment of the nature of operationally burdensome situations, the institution must take account of the low materiality and short holding period of such positions. A holding period of short duration requires the strong liquidity of the index to be evidenced by the institution.

(2) For the purpose of sub-paragraph (1), a position must be regarded to be of low materiality where all of the following conditions are met–

(a) the individual net exposure arising from index holdings measured before any look-through is performed does not exceed 2% of Common Equity Tier 1 items as calculated in Article 46(1)(a);

(b) the aggregated net exposure arising from index holdings measured before any look-through is performed does not exceed 5% of Common Equity Tier 1 items as calculated in Article 46(1)(a);

(c) the sum of the aggregated net exposure arising from index holdings measured before any look-through is performed and of any other holdings that are deducted pursuant to Article 36(1)(h) does not exceed 10% of Common Equity Tier 1 items as calculated in Article 46(1)(a).

Supervisory permission for reduction of own funds

Article 77: process requirements, etc. for application to reduce own funds.

41.(1) Redemptions, reductions and repurchases of own funds instruments must not be announced to holders of the instruments before the institution has obtained the prior permission of the GFSC.

(2) Where the actions listed in Article 77(1) are expected to take place with sufficient certainty, and once the prior permission of the GFSC has been obtained, the institution must deduct the corresponding amounts to be redeemed, reduced, repurchased, repaid or called or the amounts of the related share premium accounts to be reduced, distributed or reclassified,

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

as applicable, from corresponding elements of its own funds before the effective redemptions, reductions, repurchases, distributions, repayments, reclassifications or calls occur. Sufficient certainty exists, in particular, when the institution has publicly announced its intention to redeem, reduce, repurchase, repay, reclassify or call an own funds instrument.

(3) When applying for a general prior permission for actions listed in Article 77(1), institutions must inform the GFSC where the related own funds instruments are purchased for the purposes of being passed on to employees of the institution as part of their remuneration and deduct these instruments from own funds on a corresponding deduction approach for the time they are held by the institution. A deduction on a corresponding basis is no longer required, where the expenses related to any action according to this sub-paragraph are already included in own funds as a result of an interim or a year-end financial report.

Article 77(1): submission of application to reduce own funds.

42. An institution must submit an application for prior permission, including general prior permission, to the GFSC before taking an action referred to in Article 77(1).

Article 77(1): content of applications.

43.(1) The application referred to in paragraph 42 must be accompanied by the following information–

(a) a well-founded explanation of the rationale for performing any of the actions referred to in Article 77(1);

(b) whether the permission sought is based on paragraph (a) or (b) of the first sub-paragraph of Article 78(1) or whether it is a general prior permission pursuant to the second sub-paragraph of Article 78(1);

(c) where the institution seeks to call, redeem or repurchase Additional Tier 1 or Tier 2 instruments or related share premium accounts during the five years following their date of issuance pursuant to Article 78(4), how the conditions of that article are met;

(d) present and forward-looking information, that covers at least a three year period, on the amounts and percentages corresponding to the following requirements for own funds and eligible liabilities, including the level and composition of own funds before and after the performing of the action and the impact on regulatory requirements–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(i) the Common Equity Tier 1 capital requirement in Article 92(1)(a), the Tier 1 capital requirement in Article 92(1)(b), and the own funds requirement in Article 92(1)(c);

(ii) the additional Common Equity Tier 1 capital, the additional Tier 1 capital, and the additional own funds that the institution is required to hold by the GFSC pursuant to regulation 140A of the CICR Regulations, where applicable;

(iii) the combined buffer requirement as defined in regulation 82 of the CICR Regulations;

(iv) the minimum leverage ratio requirement in Article 92(1)(d), and, where applicable, any adjustment in accordance with Article 429A(7);

(v) the additional Common Equity Tier 1 capital requirement and additional Tier 1 capital requirement referred to in regulation 140A of the CICR Regulations, where applicable;

(vi) the additional leverage ratio buffer in Article 92(1A), where applicable;

(vii) the risk-based requirement for own funds and eligible liabilities under Article 92A(1)(a) or 92B, where applicable, as well as the non-risk based requirement for own funds and eligible liabilities under Article 92A(1)(b) or 92B, where applicable;

(viii) the minimum requirement for own funds and eligible liabilities referred to in regulation 45(1) of the Financial Services (Recovery and Resolution) Regulations 2020 as required in accordance with regulations 45E and 45Fof those Regulations, as applicable, calculated as the amount of own funds and eligible liabilities, and expressed as percentages of–

(aa) the total risk exposure amount of the institution, calculated in accordance with Article 92(3); and

(bb) the amount of own funds and eligible liabilities expressed as percentages of the total exposure measure of the relevant entity, calculated in accordance with Articles 429(4) and 429A;

(e) present and forward-looking information on the level and composition of own funds and the level and composition of own funds and eligible liabilities held to ensure compliance, respectively, with the requirements referred to in paragraph

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(d)(i) to (viii) before and after performing any of the actions listed in Article 77(1). The information must cover at least a three year period;

(f) the institution's summary assessment on the impact of the action that the institution has planned to take in accordance with Article 77(1), and any such action that the institution additionally envisages to undertake within a three year period, on compliance with the requirements referred to in paragraph (d)(i) to (viii);

(g) where the institution seeks to replace own funds instruments or the related share premium accounts pursuant to Article 78(1)(a) or Article 78(4)(d)–

(i) information on the residual maturity of the replaced own funds instruments, if any, and the maturity of the own funds instruments replacing them;

(i) the ranking in insolvency hierarchy of the replaced own funds instruments and of the own funds instruments replacing them;

(ii) the cost of the own funds instruments replacing the instruments or the shared premium accounts referred to in Article 77(1);

(iii) the planned timing of the issuance of the own funds instruments replacing the instruments or share premium accounts referred to in Article 77(1);

(iv) the impact on the profitability of the institution of a replacement of a capital instrument as specified in pursuant to Article 78(1)(a) or 78(4)(d);

(h) an evaluation of the risks to which the institution is or might be exposed and whether the level of own funds and eligible liabilities ensures an appropriate coverage of such risks, including outcomes of stress tests on main risks evidencing potential losses;

(i) coverage in terms of own funds of the level and composition of any additional own funds that the institution is expected to hold by the GFSC, in excess of the requirements set out in paragraph (d)(i) to (viii), before and after performing any of the actions listed in Article 77(1), covering a three year period;

(j) any other information considered necessary by the GFSC for evaluating the appropriateness of granting a permission in accordance with Article 78.

(2) An institution is not required to submit the information listed in sub-paragraph (1) if the GFSC already has the information.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Article 77(1): additional information to be submitted with application for general prior permission for listed action.

44.(1) Where a general prior permission pursuant to the second sub-paragraph of Article 78(1) for an action under Article 77(1)(a) is sought, the application must specify the amount of each relevant Common Equity Tier 1 issue subject to the request.

(2) Where a general prior permission for an action under Article 77(1)(c) is sought, the institution must specify in the application–

(a) the amount of each relevant outstanding issue subject to the request; and

(b) the total carrying amount of outstanding instruments in each relevant tier of capital.

(3) An application for a general prior permission for an action under Article 77(1) (a) and (d) for market making purposes may include own funds instruments still to be issued, subject to specification of the information referred to in sub-paragraph (2)(a) and (b), as applicable, being provided to the GFSC following the relevant issuance.

Article 77(1): information to be submitted with application to renew a general prior permission for listed actions.

45.(1) Before the expiry of a general prior permission granted pursuant to the second sub-paragraph of Article 78(1), an institution may submit an application for its renewal for a period of up to one additional year each time, but the institution cannot–

(a) request an increase in the predetermined amount set when the general prior permission was granted; or

(b) change the rationale referred to in paragraph 43(1)(a) when the general prior permission was initially requested.

(2) When applying for the renewal of a general prior permission under sub-paragraph (1), the institution is exempt from the obligation to provide the information referred to in paragraph 43(1)(a) to (d), (f), (g) and (i).

Article 77(1): timing of application to be submitted by institution.

46.(1) For a prior permission, other than a general prior permission referred to in the second sub-paragraph of Article 78(1), the institution must transmit a complete application and the information referred to in Article 30 to the GFSC at least three months before the date when one of the actions listed in Article 77(1) will be announced to the holders of the instruments.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(2) For a general prior permission referred to in the second subparagraph of Article 78(1), the institution must transmit a complete application and the information referred to in Articles 30 and 30A to the GFSC at least three months before the date when any of the actions listed in Article 77(1) will be carried out.

(3) Similarly, where a renewal of a general prior permission pursuant to the second subparagraph of Article 78(1) and Article 30B is sought, the institution must transmit the application and the information required under Articles 30, 30A and 30B to the GFSC at least three months before the expiration of the period for which the general prior permission was granted.

(4) Where there are exceptional circumstances which may make it impracticable to transmit the application referred to in sub-paragraphs (1) to (3) within a time frame set out in those paragraphs, the institution must submit the application as soon as is practicable.

Article 77(1): applications for redemptions, reductions and repurchases by mutuals, co-operative societies, savings institutions or similar institutions.

47.(1) With regard to the redemption of Common Equity Tier 1 instruments of mutuals, co-operative societies, savings institutions or similar institutions, the application referred to in paragraph 29(1) and the information referred to in paragraph 30(1) must be submitted to the GFSC at least three months before the date when any of the actions listed in Article 77 will be carried out.

(2) An institution may apply for a permission under Article 77 in advance to an action listed in Article 77(1) for a certain predetermined amount to be redeemed, net of the amount of the subscription of new paid in Common Equity Tier 1 instruments during a period up to one year. That predetermined amount may go up to 2% of Common Equity Tier 1 capital, if the institution demonstrates to the GFSC that this action will not pose a danger to the current or future solvency situation of the institution.

Temporary waiver from deduction from own funds

Article 79(1): temporary waiver from deduction of own funds.

48.(1) A temporary waiver must be of a duration that does not exceed the timeframe envisaged under the financial assistance operation plan and must not be granted for a period longer than 5 years.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(2) If granted by the GFSC, a temporary waiver must apply only in relation to new holdings of own funds instruments in a financial sector entity subject to the financial assistance operation.

(3) For the purposes of providing a temporary waiver for deduction from own funds, the GFSC may deem the holdings referred to in Article 79(1) to be held for the purposes of a financial assistance operation designed to reorganise and save a financial sector entity where the operation is carried out under a plan and approved by the GFSC, and where the plan clearly states phases, timing and objectives and specifies the interaction between the holdings and the financial assistance operation.

CHAPTER 5
MINORITY INTEREST AND ADDITIONAL TIER 1 AND TIER 2 INSTRUMENTS ISSUED BY SUBSIDIARIES

Minority interests included in consolidated Common Equity Tier 1 capital.

49.(1) For the purpose of specifying the sub-consolidation calculation required in accordance with Articles 84(2), 85(2) and 87(2), the qualifying minority interests of a subsidiary referred to in Article 81 that is itself a parent undertaking of an entity referred to in Article 81(1) must be calculated as described in sub-paragraphs (2) to (4).

(2) Where the GFSC has exercised the discretion referred to in Article 9(1), the calculation to be undertaken in accordance with sub-paragraphs (3) and (4) must be made on the basis of the situation of the institution as if the discretion had not been exercised.

(3) Where the subsidiary complies with the provisions of Part 3 of the principal Standards on the basis of its consolidated situation the following treatment applies–

(a) the Common Equity Tier 1 capital of that subsidiary on its consolidated basis referred to in Article 84(1)(a) must include the eligible minority interests that arise from its own subsidiaries calculated pursuant to Article 84 and the provisions of this Part;

(b) for the purpose of the sub-consolidation calculation, the amount of Common Equity Tier 1 capital required according to Article 84(1)(a)(i) must be the amount required to meet the Common Equity Tier 1 requirements of that subsidiary at the level of its consolidated situation calculated in accordance with Article 84(1)(a). The specific own funds requirements referred to must be the ones set by the competent authority of the subsidiary under regulation 34 of the CICR;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(c) the amount of consolidated Common Equity Tier 1 capital required, according to Article 84(1)(a)(ii), must be the contribution of the subsidiary on the basis of its consolidated situation to the Common Equity Tier 1 own funds requirements of the institution for which the eligible minority interests are calculated on a consolidated basis. For the purpose of calculating the contribution, all intra-group transactions between undertakings included in the prudential scope of consolidation of the institution must be eliminated.

(4) When performing the consolidation referred to in sub-paragraph (3)(c), the subsidiary must not include capital requirements arising from its subsidiaries which are not included in the prudential scope of consolidation of the institution for which the eligible minority interests are calculated.

(5) Where the waiver referred to in Article 84(3) applies to a subsidiary, any parent undertaking of the subsidiary benefiting from the waiver may include in its Common Equity Tier 1 capital minority interests arising from subsidiaries of the subsidiary itself benefiting from the waiver if the calculations referred to in Article 84(1) and in this Part have been made for each of those subsidiaries. The amount of Common Equity Tier 1 included in the own funds at the level of the parent undertaking must not exceed the amount that would be included if no waiver had been granted to the subsidiary.

(6) Where a parent institution has an intermediate subsidiary which is not referred to in Article 81(1) and where this intermediate subsidiary itself has subsidiaries which are referred to in Article 81(1), the parent institution may include in its Common Equity Tier 1 capital the amount of minority interest arising from those subsidiaries calculated according to Article 84(1). The parent institution cannot, however, include in its Common Equity Tier 1 capital any minority interests arising from an intermediate subsidiary which is not referred to in Article 81(1).

(7) The methodology set out in sub-paragraphs (2) to (4) also applies *mutatis mutandis* for the calculation of the amount of qualifying Tier 1 instruments under Article 85 and the amount of qualifying own funds under Article 87, where references to Common Equity Tier 1 must be read as references to Tier 1 or own funds.

PART 2
REQUIREMENTS SUPPLEMENTING ARTICLE 105 ON STANDARDS FOR PRUDENTIAL VALUATION

CHAPTER 1
GENERAL PROVISIONS

Methodology for calculating additional valuation adjustments (AVAs).

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

50. Institutions must calculate the total additional valuation adjustments (“AVAs”) necessary to adjust the fair values to the prudent value and must calculate those AVAs quarterly according to the method in Chapter 3 unless they meet the conditions for applying the method in Chapter 2.

Interpretation.

51. For the purpose of this Part–

“valuation exposure” means the amount of a valuation position which is sensitive to the movement in a valuation input;

“valuation input” means a market observable or non-observable parameter or matrix of parameters that influences the fair value of a valuation position;

“valuation position” means a financial instrument or commodity or portfolio of financial instruments or commodities held in both trading and non-trading books, which are measured at fair value.

Sources of market data.

52.(1) Where institutions calculate AVAs based on market data, they must consider the same range of market data as the data used in the independent price verification (“IPV”) process in Article 105(8), as relevant, subject to the adjustments in this paragraph.

(2) Institutions must consider a full range of available and reliable market data sources to determine a prudent value including each of the following, where relevant–

(a) exchange prices in a liquid market;

(b) trades in the exact same or very similar instrument, either from the institution's own records or, where available, trades from across the market;

(c) tradable quotes from brokers and other market participants;

(d) consensus service data;

(e) indicative broker quotes;

(f) counterparty collateral valuations.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(3) For cases where an expert-based approach is applied for the purpose of paragraphs 58, 59 and 60, alternative methods and sources of information must be considered, including each of the following, where relevant–

(a) the use of proxy data based on similar instruments for which sufficient data is available;

(b) the application of prudent shifts to valuation inputs;

(c) the identification of natural bounds to the value of an instrument.

CHAPTER 2
SIMPLIFIED APPROACH FOR THE DETERMINATION OF AVAs

Conditions for use of the simplified approach.

53.(1) Institutions may apply the simplified approach described in this Chapter only if the sum of the absolute value of fair-valued assets and liabilities, as stated in the institution's financial statements under the applicable accounting framework, is less than £13 billion.

(2) Exactly matching, offsetting fair-valued assets and liabilities must be excluded from the calculation in sub-paragraph (1). For fair-valued assets and liabilities for which a change in accounting valuation has a partial or zero impact on Common Equity Tier 1 (“CET1”) capital, their values must only be included in proportion to the impact of the relevant valuation change on CET1 capital.

(3) The threshold referred to in sub-paragraph (1) applies on an individual and consolidated basis. Where the threshold is breached on a consolidated basis, the core approach must be applied to all entities included in the consolidation.

(4) Where institutions applying the simplified approach fail to meet the condition in sub-paragraph (1) for two consecutive quarters, they must immediately notify the GFSC and agree on a plan to implement the approach in Chapter 3 within the following two quarters.

Determination of AVAs under simplified approach.

54. Institutions must calculate AVAs under the simplified approach as 0.1% of the sum of the absolute value of fair-valued assets and liabilities which are included within the threshold calculation in paragraph 53.

Determination of total AVAs calculated under simplified approach.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

55. For institutions applying the simplified approach, the total AVAs for the purpose of paragraph 50 must be the AVA resulting from the calculation in paragraph 54.

CHAPTER 3
CORE APPROACH FOR THE DETERMINATION OF AVAs

Overview of the core approach.

56.(1) Institutions must calculate AVAs under the core approach, by applying the following two-step approach–

(a) they must calculate AVAs for each of the categories described in Article 105(10) and (11) (“category level AVAs'”) according to sub-paragraph (2);

(b) they must sum the resulting amounts for each of the category level AVAs to provide the total AVAs for the purposes of paragraph 50.

(2) For the purposes of sub-paragraph (1)(a), institutions must calculate category level AVAs in one of the following ways–

(a) according to paragraphs 58 to 67;

(b) where the application of paragraphs 58 to 67 is not possible for certain positions, according to a `fallback approach', whereby they identify the related financial instruments and calculate an AVA as the sum of the following–

(i) 100% of the net unrealised profit on the related financial instruments;

(ii) 10% of the notional value of the related financial instruments in the case of derivatives;

(iii) 25% of the absolute value of the difference between the fair value and the unrealised profit, as determined under sub-paragraph (i), of the related financial instruments in the case of non-derivatives,

and for the purposes of paragraph (b)(i), “unrealised profit” means the change, where positive, in fair value since trade inception, determined on a first-in-first-out basis.

General provisions for the calculations of AVAs under core approach.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

57.(1) For fair-valued assets and liabilities for which a change in accounting valuation has a partial or zero impact on CET1 capital, AVAs must only be calculated based on the proportion of the accounting valuation change that impacts CET1 capital.

(2) In relation to the category level AVAs in paragraphs 64 to 67, institutions must aim to achieve a level of certainty in the prudent value that is equivalent to that set out in paragraphs 58 to 63.

(3) AVAs must be considered to be the excess of valuation adjustments required to achieve the identified prudent value, over any adjustment applied in the institution's fair value that can be identified as addressing the same source of valuation uncertainty as the AVA. Where an adjustment applied in the institution's fair value cannot be identified as addressing a specific AVA category at the level at which the relevant AVAs are calculated, that adjustment must not be included in the calculation of AVAs.

(4) AVAs must always be positive, including at valuation exposure level, category level, both pre and post aggregation.

Calculation of market price uncertainty AVA.

58.(1) Market price uncertainty AVAs must be calculated at valuation exposure level ("individual market price uncertainty AVAs").

(2) The market price uncertainty AVA must only be assessed to have zero value where both of the following conditions are met–

(a) the institution has firm evidence of a tradable price for a valuation exposure or a price can be determined from reliable data based on a liquid two-way market as described in the second sub-paragraph of Article 338(1);

(b) the sources of market data set out in paragraph 52(2) do not indicate any material valuation uncertainty.

(3) Where a valuation exposure cannot be shown to have a zero AVA, when assessing the market price uncertainty AVA institutions must use the data sources in paragraph 52. In this case the calculation of the market price uncertainty AVA must be performed as described in sub-paragraphs (4) and (5).

(4) Institutions must calculate AVAs on valuation exposures related to each valuation input used in the relevant valuation model and–

(a) the granularity at which those AVAs is assessed must be one of the following–

(i) where decomposed, all the valuation inputs required to calculate an exit price for the valuation position;

(ii) the price of the instrument;

(b) each of the valuation inputs in paragraph (a)(i) must be treated separately. Where a valuation input consists of a matrix of parameters, AVAs must be calculated based on the valuation exposures related to each parameter within that matrix and, where a valuation input does not refer to tradable instruments, institutions must map the valuation input and the related valuation exposure to a set of market tradable instruments. Institutions may reduce the number of parameters of the valuation input for the purpose of calculating AVAs using any appropriate methodology provided the reduced parameters satisfy all of the following requirements–

(i) the total value of the reduced valuation exposure is the same as the total value of the original valuation exposure;

(ii) the reduced set of parameters can be mapped to a set of market tradable instruments;

(iii) the ratio of variance measure 2 over variance measure 1, based on historical data from the most recent 100 trading days, is less than 0.1 and, for the purposes of this sub-paragraph–

(aa) "variance measure 1" means the profit and loss variance of the valuation exposure based on the unreduced valuation input; and

(bb) "variance measure 2" means the profit and loss variance of the valuation exposure based on the unreduced valuation input minus the valuation exposure based on the reduced valuation input;

(c) where a reduced number of parameters is used for the purpose of calculating AVAs, the determination that the criteria set out in paragraph (b) are met must be subject to independent control function review of the netting methodology and internal validation on at least an annual basis.

(5) Market price uncertainty AVAs must be determined as follows–

(a) where sufficient data exists to construct a range of plausible values for a valuation input–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(i) for a valuation input where the range of plausible values is based on exit prices, institutions must estimate a point within the range where they are 90% confident they could exit the valuation exposure at that price or better;

(ii) for a valuation input where the range of plausible values is created from mid prices, institutions must estimate a point within the range where they are 90% confident that the mid value they could achieve in exiting the valuation exposure would be at that price or better;

(b) where insufficient data exists to construct a plausible range of values for a valuation input, institutions must–

(i) use an expert-based approach using qualitative and quantitative information available to achieve a level of certainty in the prudent value of the valuation input that is equivalent to that targeted under paragraph (a);

(ii) notify the GFSC of the valuation exposures for which this approach is applied, and the methodology used to determine the AVA;

(c) institutions must calculate the market price uncertainty AVA based on one of the following approaches–

(i) they shall apply the difference between the valuation input values estimated according to either paragraph (a) or paragraph (b), and the valuation input values used for calculating fair value to the valuation exposure of each valuation position;

(ii) they shall combine the valuation input values estimated according to either paragraph (a) or paragraph (b) and they shall revalue valuation positions based on those values. Institutions shall then take the difference between the revalued positions and fair-valued positions.

(6) Institutions must calculate the total category level AVA for market price uncertainty by applying to individual market price uncertainty AVAs the formulae for either Method 1 or Method 2 in paragraph 61.

Calculation of close-out costs AVA.

59.(1) Close-out costs AVAs must be calculated at valuation exposure level ("individual close-out costs AVAs").

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(2) When an institution has calculated a market price uncertainty AVA for a valuation exposure based on an exit price, the close-out cost AVA may be assessed to have zero value.

(3) Where an institution applies the derogation in Article 105(5), the close-out costs AVA may be assessed to have zero value, on the condition that the institution provides evidence that it is 90% confident that sufficient liquidity exists to support the exit of the related valuation exposures at mid-price.

(4) Where a valuation exposure cannot be shown to have a zero close-out costs AVA, institutions must use the data sources in paragraph 52. In this case the calculation of the close-out costs AVA must be performed as described in sub-paragraphs (5) and (6).

(5) Institutions must calculate close-out costs AVAs on valuation exposures related to each valuation input used in the relevant valuation model and–

(a) the granularity at which those close-out costs AVAs is assessed must be one of the following–

(i) where decomposed, all valuation inputs required to calculate an exit price for the valuation position;

(ii) the price of the instrument;

(b) each of the valuation inputs in paragraph (a)(i) must be treated separately. Where a valuation input consists of a matrix of parameters, institutions must assess the close-out cost AVA based on the valuation exposures related to each parameter within that matrix and, where a valuation input does not refer to tradable instruments, institutions must explicitly map the valuation input and the related valuation exposure to a set of market tradable instruments. Institutions may reduce the number of parameters of the valuation input for the purpose of calculating AVAs using any appropriate methodology provided the reduced parameters satisfy all of the following requirements–

(i) the total value of the reduced valuation exposure is the same as the total value of the original valuation exposure;

(ii) the reduced set of parameters can be mapped to a set of market tradable instruments;

(iii) the ratio of variance measure 2 over variance measure 1, based on historical data from the most recent 100 trading days, is less than 0.1 and, for the purposes of this paragraph–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(aa) "variance measure 1" means the profit and loss variance of the valuation exposure based on the unreduced valuation input; and

(bb) "variance measure 2" means the profit and loss variance of the valuation exposure based on the unreduced valuation input minus the valuation exposure based on the reduced valuation input;

(c) where a reduced number of parameters is used for the purpose of calculating AVAs, the determination that the criteria set out in paragraph (b) are met must be subject to independent control function review and internal validation on at least an annual basis.

(6) Close-out costs AVAs must be determined as follows–

(a) where sufficient data exists to construct a range of plausible bid-offer spreads for a valuation input, institutions must estimate a point within the range where they are 90% confident that the spread they could achieve in exiting the valuation exposure would be at that price or better;

(b) where insufficient data exists to construct a plausible range of bid-offer spreads, institutions must–

(i) use an expert-based approach using qualitative and quantitative information available to achieve a level of certainty in the prudent value that is equivalent to that targeted where a range of plausible values is available;

(ii) notify the GFSC of the valuation exposures for which this approach is applied, and the methodology used to determine the AVA;

(c) institutions must calculate the close-out costs AVA by applying 50% of the estimated bid-offer spread calculated in accordance with either paragraph (a) or (b) to the valuation exposures related to the valuation inputs defined in sub-paragraph (5).

(7) Institutions must calculate the total category level AVA for close-out costs by applying to the individual close-out costs AVAs the formulae for either Method 1 or Method 2 in paragraph 61.

Calculation of model risk AVA.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

60.(1) Institutions must estimate a model risk AVA for each valuation model ("individual model risk AVA") by considering valuation model risk which arises due to the potential existence of a range of different models or model calibrations, which are used by market participants, and the lack of a firm exit price for the specific product being valued. Institutions must not consider valuation model risk which arises due to calibrations from market derived parameters, which must be captured according to paragraph 58.

(2) The model risk AVA must be calculated using one of the approaches in sub-paragraphs (3) and (4).

(3) Where possible, institutions must calculate the model risk AVA by determining a range of plausible valuations produced from alternative appropriate modelling and calibration approaches. In this case, institutions must estimate a point within the resulting range of valuations where they are 90% confident they could exit the valuation exposure at that price or better.

(4) Where institutions are unable to use the approach in sub-paragraph (3), they must apply an expert-based approach to estimate the model risk AVA.

(5) The expert-based approach must consider all of the following–

(a) complexity of products relevant to the model;

(b) diversity of possible mathematical approaches and model parameters, where those model parameters are not related to market variables;

(c) the degree to which the market for relevant products is `one way';

(d) the existence of unhedgeable risks in relevant products;

(e) the adequacy of the model in capturing the behaviour of the pay-off of the products in the portfolio.

Institutions must notify the GFSC of the models for which this approach is applied, and the methodology used to determine the AVA.

(6) Where institutions use the method in sub-paragraph (4), the prudence of the method must be confirmed annually by comparing the following–

(a) the AVAs calculated using the method in sub-paragraph (4), if it were applied to a material sample of the valuation models for which the institution applies the method in sub-paragraph (3); and

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(b) the AVAs produced by the method in sub-paragraph (3) for the same sample of valuation models.

(7) Institutions must calculate the total category level AVA for model risk by applying to individual model risk AVAs the formulae for either Method 1 or Method 2 in paragraph 61.

Aggregating formulae.

61.(1) The formulae to be used for the purpose of aggregating AVAs under paragraphs 58(6), 59(7) and 60(7) are as follows.

(2) The formula for method 1 is–

APVA	= (FV - PV) - a • (FV - PV) = (1 - a) • (FV - PV)
AVA	= Z APVA

(3) The formula for Method 2 is–

APVA	= max {0, (FV - PV) - a • (EV - PV)} = max {0, FV - a • EV - (1 - a) • PV}
AVA	= Z APVA

(4) In those formulae–

FV = the valuation exposure-level fair value after any accounting adjustment applied in the institution's fair value that can be identified as addressing the same source of valuation uncertainty as the relevant AVA;

PV = the valuation exposure-level prudent value determined in accordance with this Chapter;

EV = the expected value at a valuation exposure level taken from a range of possible values;

a = the aggregation factor, which institutions must set at 50%;

APVA = the valuation exposure-level AVA after adjusting for aggregation;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

AVA = the total category-level AVA after adjusting for aggregation.

Calculation of unearned credit spreads AVA.

62.(1) Institutions must calculate the unearned credit spreads AVA to reflect the valuation uncertainty in the adjustment necessary according to the applicable accounting framework to include the current value of expected losses due to counterparty default on derivative positions.

(2) Institutions must include–

(a) the element of the AVA relating to market price uncertainty within the market price uncertainty AVA category;

(b) the element of the AVA relating to close-out cost uncertainty within the close-out costs AVA category;

(c) the element of the AVA relating to model risk within the model risk AVA category.

Calculation of investing and funding costs AVA.

63.(1) Institutions must calculate the investing and funding costs AVA to reflect the valuation uncertainty in the funding costs used when assessing the exit price according to the applicable accounting framework.

(2) Institutions must include–

(a) element of the AVA relating to market price uncertainty within the market price uncertainty AVA category;

(b) the element of the AVA relating to close-out cost uncertainty within the close-out costs AVA category;

(c) the element of the AVA relating to model risk within the model risk AVA category.

Calculation of concentrated positions AVA.

64.(1) Institutions must estimate a concentrated position AVA for concentrated valuation positions ("individual concentrated positions AVA") by applying the following three-step approach–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) they must identify concentrated valuation positions;

(b) for each identified concentrated valuation position, where a market price applicable for the size of the valuation position is unavailable, they must estimate a prudent exit period;

(c) where the prudent exit period exceeds 10 days, they must estimate an AVA taking account of the volatility of the valuation input, the volatility of the bid offer spread and the impact of the hypothetical exit strategy on market prices.

(2) For the purposes of sub-paragraph (1)(a), the identification of concentrated valuation positions must consider all of the following–

(a) the size of all valuation positions relative to the liquidity of the related market;

(b) the institution's ability to trade in that market;

(c) the average daily market volume and typical daily trading volume of the institution.

(3) Institutions must establish and document the methodology applied to determine concentrated valuation positions for which a concentrated positions AVA must be calculated.

(4) Institutions must calculate the total category level AVA for concentrated positions AVA as the sum of individual concentrated positions AVAs.

Calculation of future administrative costs AVA.

65.(1) Where an institution calculates market price uncertainty and close-out cost AVAs for a valuation exposure, which imply fully exiting the exposure, the institution may assess a zero AVA for future administrative costs.

(2) Where a valuation exposure cannot be shown to have a zero AVA according to sub-paragraph (1), institutions must calculate the future administrative cost AVA ("individual future administrative costs AVA") considering the administrative costs and future hedging costs over the expected life of the valuation exposures for which a direct exit price is not applied for the close-out costs AVA, discounted using a rate which approximates the risk free rate.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(3) For the purposes of sub-paragraph (2), future administrative costs must include all incremental staffing and fixed costs that are likely to be incurred in managing the portfolio but a reduction in these costs may be assumed as the size of the portfolio reduces.

(4) Institutions must calculate the total category level AVA for future administrative costs AVA as the sum of individual future administrative costs AVAs.

Calculation of early termination AVA.

66.(1) Institutions must estimate an early termination AVA considering the potential losses arising from non-contractual early terminations of client trades.

(2) The early termination AVA must be calculated taking account of the percentage of client trades that have historically terminated early and the losses that arise in those cases.

Calculation of operational risk AVA.

67.(1) Institutions must estimate an operational risk AVA by assessing the potential losses that may be incurred as a result of operational risk related to valuation processes. That estimate must include an assessment of valuation positions judged to be at-risk during the balance sheet substantiation process, including those due to legal disputes.

(2) Where an institution applies the advanced measurement approach for operational risk specified in Chapter 4 of Title 3 of Part 3 the principal Standards, it may report a zero operational risk AVA on condition that it provides evidence that the operational risk relating to valuation processes, as determined in accordance with sub-paragraph (1), is fully accounted for by the advanced measurement approach calculation.

(3) In cases other than those referred to in sub-paragraph (2), the institution must calculate an operational risk AVA of 10% of the sum of the aggregated category level AVAs for market price uncertainty and close-out costs.

Documentation requirements.

68.(1) Institutions must document appropriately the prudent valuation methodology and that documentation must include internal policies providing guidance on all of the following–

(a) the range of methodologies for quantifying AVAs for each valuation position;

(b) the hierarchy of methodologies for each asset class, product, or valuation position;

(c) the hierarchy of market data sources used in the AVA methodology;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(d) the required characteristics of market data to justify a zero AVA for each asset class, product, or valuation position;

(e) the methodology applied where an expert-based approach is used to determine an AVA;

(f) the methodology for determining whether a valuation position requires a concentrated position AVA;

(g) the assumed exit horizon for the purpose of calculating AVAs for concentrated positions, where relevant;

(h) the fair-valued assets and liabilities for which a change in accounting valuation has a partial or zero impact on CET1 capital according to paragraphs 53(2) and 57(1).

(2) Institutions must also maintain records to allow the calculation of AVAs at valuation exposure level to be analysed, and information from the AVA calculation process must be provided to senior management to allow an understanding of the level of valuation uncertainty on the institution's portfolio of fair-valued positions.

(3) The documentation specified in sub-paragraph (1) must be reviewed at least annually and approved by senior management.

Systems and controls requirements.

69.(1) AVAs must be authorised initially, and monitored subsequently, by an independent control unit.

(2) Institutions must have effective controls related to the governance of all fair-valued positions, and adequate resources to implement those controls and ensure robust valuation processes even during a stressed period, which include all of the following–

(a) at least an annual review of valuation model performance;

(b) management sign-off on all significant changes to valuation policies;

(c) a clear statement of the institution's risk appetite for exposure to positions subject to valuation uncertainty which is monitored at an aggregate institution-wide level;

(d) independence in the valuation process between risk taking and control units;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(e) a comprehensive internal audit process related to valuation processes and controls.

(3) Institutions must ensure there are effective and consistently applied controls related to the valuation process for fair-valued positions. Those controls must be subject to regular internal audit review and include all of the following–

(a) a precisely defined institution-wide product inventory, ensuring that every valuation position is uniquely mapped to a product definition;

(b) valuation methodologies, for each product in the inventory covering choice and calibration of model, fair value adjustments, AVAs, independent price verification methodologies applicable to the product, and the measurement of valuation uncertainty;

(c) validation process ensuring that, for each product, both the risk-taking and relevant control departments approve the product-level methodologies described in paragraph (b) and certify that they reflect the actual practice for every valuation position mapped to the product;

(d) defined thresholds based on observed market data for determining when valuation models are no longer sufficiently robust;

(e) a formal IPV process based on prices independent from the relevant trading desk;

(f) a new product approval processes referencing the product inventory and involving all internal stakeholders relevant to risk measurement, risk control, financial reporting and the assignment and verification of valuations of financial instruments;

(g) a new deal review process to ensure that pricing data from new trades are used to assess whether valuations of similar valuation exposures remain appropriately prudent.

PART 3
SUPPLEMENTARY REQUIREMENTS FOR DETERMINING OVERALL EXPOSURE TO CLIENTS OR GROUPS OF CONNECTED CLIENTS IN RESPECT OF TRANSACTIONS WITH UNDERLYING ASSETS

Introduction.

70. This Part specifies–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) the conditions and methodologies used to determine the overall exposure of an institution to a client or a group of connected clients in respect of exposures through transactions with underlying assets; and

(b) the conditions under which the structure of transactions with underlying assets does not constitute an additional exposure.

Interpretation.

71.(1) For the purposes of this Part–

"transactions" means transactions referred to in Article 112(m) and (o) and other transactions where there is an exposure to underlying assets;

"unknown client" means a single hypothetical client to which the institution assigns all exposures for which it has not identified the obligor, where paragraph 75(2)(a) and (b) and (3)(a) are not applicable.

Identification of exposures resulting from transactions.

72.(1) An institution must determine the contribution to the overall exposure to a certain client or group of connected clients that results from a certain transaction in accordance with the methodology set out in paragraphs 73, 74 and 75.

(2) The institution must determine separately for each of the underlying assets its exposure to this underlying asset in accordance with paragraph 74.

(3) An institution must assess whether a certain transaction constitutes an additional exposure in accordance with paragraph 76.

Underlying exposures to transactions which have underlying assets.

73.(1) When assessing the underlying exposures of a transaction ("transaction A") which itself has an underlying exposure to another transaction ("transaction B") for the purpose of paragraphs 74 and 75, an institution must treat the exposure to transaction B as replaced with the exposures underlying transaction B.

(2) Sub-paragraph (1) applies as long as the underlying exposures are exposures to transactions with underlying assets.

Calculation of the exposure value.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

74.(1) The exposure of an institution to an underlying asset of a transaction is the lower of the following–

(a) the exposure value of the exposure arising from the underlying asset;

(b) the total exposure value of the institution's exposures to the underlying asset resulting from all exposures of the institution to the transaction.

(2) For each exposure of an institution to a transaction, the exposure value of the resulting exposure to an underlying asset must be determined as follows–

(a) if the exposures of all investors in this transaction rank *pari passu*, the exposure value of the resulting exposure to an underlying asset must be the pro rata ratio for the institution's exposure to the transaction multiplied by the exposure value of the exposure formed by the underlying asset;

(b) in cases other than those in paragraph (a) the exposure value of the resulting exposure to an underlying asset must be the pro rata ratio for the institution's exposure to the transaction multiplied by the lower of–

(i) the exposure value of the exposure formed by the underlying asset;

(ii) the total exposure value of the institution's exposure to the transaction together with all other exposures to this transaction that rank *pari passu* with the institution's exposure.

(3) The pro rata ratio for an institution's exposure to a transaction must be the exposure value of the institution's exposure divided by the total exposure value of the institution's exposure together with all other exposures to this transaction that rank *pari passu* with the institution's exposure.

Procedure for determining contribution of underlying exposures to overall exposures.

75.(1) For each credit risk exposure for which the obligor is identified, an institution must include the exposure value of its exposure to the relevant underlying asset when calculating the overall exposure to this obligor as an individual client or to the group of connected clients to which this obligor belongs.

(2) If an institution has not identified the obligor of an underlying credit risk exposure, or where an institution is unable to confirm that an underlying exposure is not a credit risk exposure, the institution must assign this exposure as follows–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) where the exposure value does not exceed 0.25% of the institution's eligible capital, it must assign this exposure to the transaction as a separate client;

(b) where the exposure value is equal to or exceeds 0.25% of the institution's eligible capital and the institution can ensure, by means of the transaction's mandate, that the underlying exposures of the transaction are not connected with any other exposures in its portfolio, including underlying exposures from other transactions, it must assign this exposure to the transaction as a separate client;

(c) in any other case, it must assign this exposure to the unknown client.

(3) If an institution is not able to distinguish the underlying exposures of a transaction, the institution must assign the total exposure value of its exposures to the transaction as follows–

(a) where this total exposure value does not exceed 0.25% of the institution's eligible capital, it must assign this total exposure value to the transaction as a separate client;

(b) in cases other than those in paragraph (a), it must assign this total exposure value to the unknown client.

(4) For the purposes of sub-paragraphs (1) and (2), institutions must regularly, and at least on a monthly basis, monitor such transactions for possible changes in the composition and the relative share of the underlying exposures.

Additional exposure constituted by structure of transaction.

76.(1) The structure of a transaction does not constitute an additional exposure if the transaction meets both of the following conditions–

(a) the legal and operational structure of the transaction is designed to prevent the manager of the transaction or a third party from redirecting any cash flows which result from the transaction to persons who are not otherwise entitled under the terms of the transaction to receive these cash flows;

(b) neither the issuer nor any other person can be required, under the transaction, to make a payment to the institution in addition to, or as an advance payment of, the cash flows from the underlying assets.

(2) The condition in sub-paragraph (1)(a) must be considered to be met where the transaction is one of the following–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) a UCITS as defined in regulation 3(1) of the Financial Services (UCITS) Regulations 2020;

(b) an undertaking established in a third country that carries out activities similar to those carried out by a UCITS and which is subject to supervision under the laws of the third country which apply supervisory and regulatory requirements at least equivalent to those applied in Gibraltar to UCITS.

PART 4
REQUIREMENTS SUPPLEMENTING THE LIQUIDITY COVERAGE REQUIREMENT FOR CREDIT INSTITUTIONS

TITLE 1
THE LIQUIDITY COVERAGE RATIO

Introduction.

77. This Part specifies in detail the liquidity coverage requirement provided for in Article 412(1).

Scope and application.

78.(1) Credit institutions must comply with this Part on an individual basis in accordance with Article 6(4).

(2) The GFSC may waive in full or in part the application of this Part on an individual basis in relation to a credit institution in accordance with Article 8 if the conditions in that Article are met.

(3) Where a group comprises one or more credit institutions, the Gibraltar parent institution, the institution controlled by a Gibraltar parent financial holding company or the institution controlled by a Gibraltar parent mixed financial holding company must apply the obligations in this Part on a consolidated basis in accordance with Article 11(3) and all the following provisions–

(a) third country assets held by a subsidiary undertaking in a third country may be recognised as liquid assets for consolidation purposes where they qualify as liquid assets under that third country's national law setting out the liquidity coverage requirement and they satisfy one of the following conditions–

(i) the assets meet all the requirements in Title 2;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(ii) the assets fail to meet the specific requirement in Title 2 with respect to their issue size but meet all the other requirements in that Title;

but the assets recognisable by virtue of sub-paragraph (ii) may only be recognised up to the amount of the stressed net liquidity outflows incurred in the particular currency in which they are denominated and arising from that same subsidiary undertaking;

(b) liquidity outflows in a subsidiary undertaking in a third country which are subject under the national law of that third country setting out the liquidity coverage requirement to higher percentages than those specified in Title 3 must be subject to consolidation in accordance with the higher rates specified in the national law of the third country;

(c) liquidity inflows in a subsidiary undertaking in a third country which are subject under the national law of that third country setting out the liquidity coverage requirement to lower percentages than those specified in Title 3 must be subject to consolidation in accordance with the lower rates specified in the national law of the third country;

(d) investment firms within the group must be subject to paragraph 80 on a consolidated basis and to Article 412 in relation to the definition of liquid assets, liquidity outflows and inflows for both individual and consolidated purposes;

(e) at a consolidated level the amount of inflows arising from a specialised credit institution referred to in paragraph 109(3) and (4) must only be recognised up to the amount of the outflows arising from the same undertaking.

Interpretation.

79. In this Part–

"asset coverage requirement" means the ratio of assets to liabilities as determined for credit enhancement purposes in relation to covered bonds by the national law of Gibraltar or a third country;

"central bank" means the Ministry of Finance or the central bank of a third country;

"common management relationship" has the meaning given in Article 4.(1);

"CRR covered bonds" has the meaning given in Article 4(1);

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

"level 1 assets" means assets of extremely high liquidity and credit quality as referred to in Article 10;

"level 2 assets" means assets of high liquidity and credit quality, and which are further subdivided into level 2A and 2B assets in accordance with paragraphs 87 and 88;

"liquidity buffer" means the amount of liquid assets that a credit institution holds in accordance with Title 2;

"margin loans" means collateralised loans extended to customers for the purpose of taking leveraged trading positions;

"net liquidity outflows" means the amount which results from deducting a credit institution's liquidity in-flows from its liquidity outflows in accordance with Title 3;

"personal investment company" ("PIC") means an undertaking or trust whose owner or beneficial owner, respectively, is an individual or a group of closely related natural individuals, which was set up with the sole purpose of managing the wealth of the owners and which does not carry out any other commercial, industrial or professional activity. The purpose of the PIC may include other ancillary activities such as segregating the owners' assets from corporate assets, facilitating the transmission of assets within a family or preventing a split of the assets after the death of a member of the family, if these are connected to the main purpose of managing the owners' wealth;

"reporting currency" means the currency in which the liquidity items referred to in Titles 2 and 3 of Part 6 of the principal Standards must be reported to the GFSC in accordance with Article 415(1);

"Securitisation Regulation" has the meaning given in the CICR Regulations;

"SME" means a micro, small and medium-sized enterprise as defined in Commission Recommendation 2003/361/EC;

"stress" means a sudden or severe deterioration in the solvency or liquidity position of a credit institution due to changes in market conditions or idiosyncratic factors as a result of which there is a significant risk that the credit institution becomes unable to meet its commitments as they fall due within the next 30 calendar days.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

The liquidity coverage ratio.

80.(1) The detailed liquidity coverage requirement in accordance with Article 412(1) must be equal to the ratio of a credit institution's liquidity buffer to its net liquidity outflows over a 30 calendar day stress period, expressed as a percentage.

Credit institutions must calculate their liquidity coverage ratio in accordance with the following formula–

$$\frac{\text{Liquidity Buffer}}{\text{Net Liquidity Outflows over a 30 calendar day stress period}} = \text{Liquidity Coverage Ratio (\%)}$$

(2) Credit institutions must maintain a liquidity coverage ratio of at least 100%.

(3) Despite sub-paragraph (2), credit institutions may monetise their liquid assets to cover their net liquidity outflows during stress periods, even if such a use of liquid assets may result in their liquidity coverage ratio falling below 100% during such periods.

(4) Where at any time the liquidity coverage ratio of a credit institution has fallen or can be reasonably expected to fall below 100%, the requirement in Article 414 applies. Until the liquidity coverage ratio has been restored to the level referred to in sub-paragraph (2), the credit institution must report to the GFSC the liquidity coverage ratio in accordance with Article 414.

(5) Credit institutions must calculate and monitor their liquidity coverage ratio in the reporting currency for all items, irrespective of their actual currency denomination.

(6) In addition, credit institutions must separately calculate and monitor their liquidity coverage ratio for certain items as follows–

(a) for items that are subject to separate reporting in a currency other than the reporting currency in accordance with Article 415(2), credit institutions must separately calculate and monitor their liquidity coverage ratio in that other currency;

(b) for items denominated in the reporting currency where the aggregate amount of liabilities denominated in currencies other than the reporting currency equals or exceeds 5% of the credit institution's total liabilities, excluding regulatory capital and off-balance-sheet items, credit institutions must separately calculate and monitor their liquidity coverage ratio in the reporting currency.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Credit institutions must report to the GFSC the liquidity coverage ratio in accordance with Commission Implementing Regulation (EU) No 680/2014.

(7) Credit institutions must not double-count liquid assets, inflows and outflows.

Stress scenarios for the purposes of the liquidity coverage ratio.

81. Credit institutions may regard the following scenarios as indicators of circumstances in which they may be considered as being subject to stress–

(a) the run-off of a significant proportion of its retail deposits;

(b) a partial or total loss of unsecured wholesale funding capacity, including wholesale deposits and other sources of contingent funding such as received committed or uncommitted liquidity or credit lines;

(c) a partial or total loss of secured short-term funding;

(d) additional liquidity outflows as a result of a credit rating downgrade of up to three notches;

(e) increased market volatility affecting the value of collateral or its quality or creating additional collateral needs;

(f) unscheduled draws on liquidity and credit facilities;

(g) potential obligation to buy-back debt or to honour non-contractual obligations.

TITLE 2
THE LIQUIDITY BUFFER

CHAPTER 1
General provisions

Composition of the liquidity buffer.

82. In order to be eligible to form part of a credit institution's liquidity buffer, the liquid assets must comply with each of the following requirements–

(a) the general requirements in paragraph 83;

(b) the operational requirements in paragraph 84;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(c) the respective eligibility criteria for their classification as a level 1 or level 2 asset in accordance with Chapter 2.

General requirements for liquid assets.

83.(1) In order to qualify as liquid assets, the assets of a credit institution must comply with sub-paragraphs (2) to (6).

(2) The assets must be a property, right, entitlement, or interest, that is held by the credit institution, or included in a pool as referred to in paragraph (a), and is free from any encumbrance.

For those purposes, an asset is considered to be unencumbered where it is not subject to any legal, contractual, regulatory or other restriction preventing the credit institution from liquidating, selling, transferring, assigning or, generally, disposing of the asset via an outright sale or a repurchase agreement within the following 30 calendar days. The following assets are considered to be unencumbered–

(a) assets included in a pool which are available for immediate use as collateral to obtain additional funding under committed but not yet funded credit lines available to the credit institution or, if the pool is operated by a central bank, under uncommitted and not yet funded credit lines available to the credit institution. Credit institutions must assume that assets in the pool are encumbered in order of increasing liquidity on the basis of the liquidity classification set out in Chapter 2, starting with assets ineligible for the liquidity buffer;

(b) assets that the credit institution has received as collateral for credit risk mitigation purposes in reverse repo or securities financing transactions and that the credit institution may dispose of.

(3) The assets must not have been issued by the credit institution itself, its parent undertaking, other than a public sector entity that is not a credit institution, its subsidiary or another subsidiary of its parent undertaking or by a securitisation special purpose entity with which the credit institution has close links;

(4) The assets must not have been issued by any of the following–

(a) another credit institution, unless one or more of the following conditions is met–

(i) the issuer is a public sector entity referred to in paragraph 86(1)(c) or 87(1)(a) or (b);

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(ii) the asset is a covered bond referred to in paragraph 86(1)(f), 87(1)(c) or (d) or 88(1)(e);

(iii) the asset belongs to the category described in paragraph 86(1)(e);

(b) an investment firm;

(c) an insurance undertaking;

(d) a reinsurance undertaking;

(e) a financial holding company;

(f) a mixed financial holding company;

(g) any other entity that performs one or more of the activities in the Schedule to the CICR Regulations as its main business (but SSPEs must be treated as not included within those entities for the purposes of this paragraph).

(5) The value of the assets must be capable of being determined–

(a) on the basis of widely disseminated and easily available market prices; or

(b) in the absence of market-based prices, on the basis of an easy-to-calculate formula that uses publicly available inputs and is not significantly dependent upon strong assumptions.

(6) The assets must be listed on a recognised exchange or tradable via active outright sale or via simple repurchase transaction on generally accepted repurchase markets. These criteria must be assessed separately for each market. An asset admitted to trading in an organised venue which is not a recognised exchange, either in Gibraltar or in a third country, must be considered liquid only where the trading venue provides for an active and sizable market for outright sales of assets. The credit institution must take account of the following as minimum criteria to assess whether a trading venue provides for an active and sizeable market for the purposes of this sub-paragraph–

(a) historical evidence of market breadth and depth as proven by low bid-ask spreads, high trading volume and a large and diverse number of market participants;

(b) the presence of a robust market infrastructure.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(7) The requirements in sub-paragraphs (5) and (6) do not apply to–

(a) banknotes and coins referred to in paragraph 86(1)(a);

(b) the exposures to central governments referred to in paragraph 86(1)(d);

(c) the exposures to central banks referred to in paragraphs 86(1)(b) and (d) and 87(1)(b);

(d) the restricted-use committed liquidity facility referred to in paragraph 88(1)(d).

Operational requirements.

84.(1) Credit institutions must have policies and limits in place to ensure that the holdings of liquid assets comprising their liquidity buffer remain appropriately diversified at all times. For those purposes, credit institutions must take account of the extent of diversification between the various categories of liquid assets and within the same category of liquid assets referred to in Chapter 2 and any other relevant diversification factors, such as types of issuers, counterparties or the geographical location of those issuers and counterparties.

The GFSC may impose specific restrictions or requirements on a credit institution's holdings of liquid assets to ensure compliance with the requirement set out in this paragraph, but any such restriction or requirement must not apply to–

(a) the following categories of level 1 assets–

(i) banknotes and coins referred to in paragraph 86(1)(a);

(ii) the exposures to central banks referred to in paragraphs 86(1)(b) and (d) and 87(1)(b);

(iii) assets representing claims on or guaranteed by the multilateral developments banks and international organisations referred to in paragraph 86(1)(g);

(b) the categories of level 1 assets representing claims on or guaranteed by the central or regional governments, local authorities or public sector entities referred to paragraph 86(1)(c) and (d), if the credit institution holds the relevant asset to cover stressed net liquidity outflows incurred in the currency of Gibraltar or a third country or the asset is issued by the government or a public sector entity in Gibraltar;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(c) the restricted-use committed liquidity facility referred to in paragraph 88(1)(d).

(2) Credit institutions must have ready access to their holdings of liquid assets and be able to monetise them at any time during the 30 calendar day stress period via outright sale or repurchase agreement on generally accepted repurchase markets. A liquid asset is considered to be readily accessible to a credit institution where there are no legal or practical impediments to the credit institution's ability to monetise such an asset in a timely fashion.

Assets used to provide credit enhancement in structured transactions or to cover operational costs of the credit institutions must not be considered as readily accessible to a credit institution.

Assets held in a third country where there are restrictions to their free transferability must be considered readily accessible only so far as the credit institution uses those assets to meet liquidity outflows in that third country. Assets held in a non-convertible currency must be considered readily accessible only so far as the credit institution uses those assets to meet liquidity outflows in that currency.

(3) Credit institutions must ensure that their liquid assets are under the control of a specific liquidity management function within the credit institution by–

(a) placing the liquid assets in a separate pool under the direct management of the liquidity function and with the sole intent of using them as a source of contingent funds, including during stress periods;

(b) putting in place internal systems and controls to give the liquidity management function effective operational control to monetise the holdings of liquid assets at any point in the 30 calendar day stress period and to access the contingent funds without directly conflicting with any existing business or risk management strategies. In particular, an asset must not be included in the liquidity buffer where monetisation of the asset without replacement throughout the 30 calendar day stress period would remove a hedge that would create an open risk position in excess of the internal limits of the credit institution; or

(c) a combination of the options in paragraphs (a) and (b), if appropriate.

(4) Credit institutions must regularly, and at least once a year, monetise a sufficiently representative sample of their holdings of liquid assets by means of outright sale or simple repurchase agreement on a generally accepted repurchase market.

Credit institutions must develop strategies for disposing of samples of liquid assets which are adequate to–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) test the access to the market for those assets and their usability;

(b) check that the credit institution's processes for the timely monetisation of assets are effective;

(c) minimise the risk of sending a negative signal to the market as a result of the credit institution's monetising its assets during stress periods.

The requirement in the first sub-paragraph does not apply to level 1 assets referred to in paragraph 86, other than extremely high quality covered bonds, or to the restricted-use committed liquidity facility referred to in paragraph 88(1)(d).

(5) The requirement in sub-paragraph (2) does not prevent credit institutions from hedging the market risk associated with their liquid assets if the following conditions are met–

(a) the credit institution puts in place appropriate internal arrangements in accordance with sub-paragraphs (2) and (3) to ensure that those assets continue to be readily available and under the control of the liquidity management function;

(b) the net liquidity outflows and inflows that would result in the event of an early close-out of the hedge are taken into account in the valuation of the relevant asset in accordance with paragraph 85.

(6) Credit institutions must ensure that the currency denomination of their liquid assets is consistent with the distribution by currency of their net liquidity outflows.

However, where appropriate, the GFSC may require credit institutions to restrict currency mismatch by setting limits on the proportion of net liquidity outflows in a currency that can be met during a stress period by holding liquid assets not denominated in that currency. That restriction may only be applied for the reporting currency or a currency that may be subject to separate reporting in accordance with Article 415(2). In determining the level of any restriction on currency mismatch that may be applied in accordance with this sub-paragraph, the GFSC must at least have regard to–

(a) whether the credit institution has the ability to do any of the following–

(i) use the liquid assets to generate liquidity in the currency and jurisdiction in which the net liquidity outflows arise;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(ii) swap currencies and raise funds in foreign currency markets during stressed conditions consistent with the 30 calendar day stress period set out in paragraph 80;

(iii) transfer a liquidity surplus from one currency to another and across jurisdictions and legal entities within its group during stressed conditions consistent with the 30 calendar day stress period set out in paragraph 80;

(b) the impact of sudden, adverse exchange rate movements on existing mismatched positions and on the effectiveness of any foreign exchange hedges in place.

Any restriction on currency mismatch imposed in accordance with this sub-paragraph must be deemed to constitute a specific liquidity requirement as referred to in regulation 141 of the CICR Regulations.

Valuation of Liquid Assets.

85. For the purposes of calculating its liquidity coverage ratio, a credit institution must use the market value of its liquid assets. The market value of liquid assets must be reduced in accordance with the haircuts set out in Chapter 2 and paragraph 84(5)(b), where applicable.

CHAPTER 2
Liquid Assets

Level 1 assets.

86.(1) Level 1 assets must only include assets falling under one or more of the following categories and in each case meeting the specified eligibility criteria–

(a) coins and banknotes;

(b) the following exposures to central banks–

(i) assets representing claims on or guaranteed by the central bank;

(ii) assets representing claims on or guaranteed by central banks of third countries, if exposures to the central bank or its central government (if applicable) are assigned a credit assessment by a nominated external credit assessment institution (ECAI) which is at least credit quality step 1 in accordance with Article 114(2) ;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(iii) reserves held by the credit institution in a central bank referred to in sub-paragraph (i) or (ii) if the credit institution is permitted to withdraw such reserves at any time during stress periods and that the conditions for such withdrawal have been specified in an agreement between the competent authority of the credit institution and the central bank in which the reserves are held, or in the applicable rules of the third country. For the purposes of this sub-paragraph, the following must apply–

(aa) where the reserves are held by a subsidiary credit institution, the conditions for the withdrawal must be specified in an agreement between the Gibraltar or third country competent authority of the subsidiary credit institution and the central bank in which the reserves are held, or in the applicable rules of the third country, as applicable;

(bb) where the reserves are held by a branch, the conditions for the withdrawal must be specified in an agreement between the competent authority of Gibraltar or the third country where the branch is located and the central bank in which the reserves are held, or in the applicable rules of the third country, as applicable;

(c) assets representing claims on or guaranteed by the following central or regional governments, local authorities or public sector entities–

(i) the government of Gibraltar;

(ii) the central government of a third country, provided that it is assigned a credit assessment by a nominated ECAI which is at least credit quality step 1 in accordance with Article 114(2) ;

(iii) regional governments or local authorities in a third country of the type referred to in sub-paragraph (ii), if they are treated as exposures to the central government of the third country in accordance with Article 115(4);

(iv) public sector entities, if they are treated as exposures to the government of Gibraltar in accordance with Article 116(4);

(d) the following assets–

(i) assets representing claims on or guaranteed by the central government or central bank of a third country which is not assigned a credit assessment of credit quality step 1 by a nominated ECAI in accordance with Article 114(2);

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(ii) reserves held by the credit institution in a central bank referred to in sub-paragraph (i), if the credit institution is permitted to withdraw those reserves at any time during stress periods and if the conditions for such withdrawal have been specified either in an agreement between the competent authorities of that third country and the central bank in which the reserves are held or in the applicable rules of that third country. For the purposes of this sub-paragraph, the following must apply–

(aa) where the reserves are held by a subsidiary credit institution, the conditions for the withdrawal must be specified either in an agreement between the third country competent authority of the subsidiary credit institution and the central bank in which the reserves are held or in the applicable rules of the third country;

(bb) where the reserves are held by a branch, the conditions for the withdrawal must be specified either in an agreement between the competent authority of the third country where the branch is located and the central bank in which the reserves are held or in the applicable rules of the third country.

The aggregate amount of assets falling within sub-paragraphs (i) and (ii) and denominated in a given currency that the credit institution may recognise as level 1 assets must not exceed the amount of the credit institution's stressed net liquidity outflows incurred in that same currency.

Moreover, where part or all of those assets are denominated in a currency which is not the domestic currency of the third country in question, the credit institution may only recognise those assets as level 1 assets up to an amount equal to the amount of the credit institution's stressed net liquidity outflows incurred in that foreign currency that corresponds to the credit institution's operations in the jurisdiction where the liquidity risk is being taken;

(e) assets issued by credit institutions which meet at least one of the following two requirements–

(i) the issuer is a credit institution incorporated or established by the government of Gibraltar, which is under the legal obligation to protect the economic basis of the credit institution and maintain its financial viability throughout its life-time;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(ii) the credit institution is a promotional lender which, for the purposes of this paragraph, must be understood as any credit institution whose purpose is to advance the public policy objectives of the government of Gibraltar predominantly through the provision of promotional loans on a non-competitive, not for profit basis, provided that at least 90% of the loans that it grants are directly or indirectly guaranteed by the government of Gibraltar;

(f) exposures in the form of extremely high quality covered bonds which comply with all of the following requirements–

(i) they are CRR covered bonds or meet the requirements to be eligible for the treatment set out in Article 129(4) or (5);

(ii) the exposures to institutions in the cover pool meet the conditions laid down in Article 129(1)(c) or, where the GFSC has granted the partial waiver referred to in the last sub-paragraph of Article 129(1), the conditions referred to in that sub-paragraph;

(iii) the credit institution investing in the covered bonds and the issuer meet the transparency requirement referred to in Article 129(7);

(iv) their issue size is at least £440 million (or the equivalent amount in domestic currency);

(v) the covered bonds are assigned a credit assessment by a nominated ECAI which is at least credit quality step 1 in accordance with Article 129(4), the equivalent credit quality step in the event of a short term credit assessment or, in the absence of a credit assessment, they are assigned a 10% risk weight in accordance with Article 129(5);

(vi) the cover pool meets at all times an asset coverage requirement of at least 2% in excess of the amount required to meet the claims attaching to the covered bonds;

(g) assets representing claims on or guaranteed by the multilateral development banks and the international organisations referred to in Article 117(2) and Article 118, respectively.

(2) The market value of extremely high quality covered bonds referred to in sub-paragraph (1)(f) must be subject to a haircut of at least 7%. Except as specified in relation to shares and

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

units in CIUs in paragraph 91(2)(b) and (c) no haircut is required on the value of the remaining level 1 assets.

Level 2A assets.

87. Level 2A assets must only include assets falling under one or more of the following categories and in each case meeting the specified eligibility criteria–

(a) assets representing claims on or guaranteed by the government of, or a public sector entity in, Gibraltar, where exposures to them are assigned a risk weight of 20% in accordance with Article 115(1) and (5) and Article 116(1), (2) and (3), as applicable;

(b) assets representing claims on or guaranteed by the central government or the central bank of a third country or by a regional government, local authority or public sector entity in a third country, if they are assigned a 20% risk weight in accordance with Articles 114(2), 115 or 116, as applicable;

(c) exposures in the form of high-quality covered bonds, which comply with all of the following requirements–

(i) they are CRR covered bonds or meet the requirements to be eligible for the treatment set out in Article 129(4) or (5);

(ii) the exposures to institutions in the cover pool meet the conditions laid down in Article 129(1)(c) or, where the GFSC has granted the partial waiver referred to in the last sub-paragraph of Article 129(1), the conditions referred to in that sub-paragraph;

(iii) the credit institution investing in the covered bonds and the issuer meet the transparency requirement laid down in Article 129(7);

(iv) their issue size is at least £220 million (or the equivalent amount in domestic currency);

(v) the covered bonds are assigned a credit assessment by a nominated ECAI which is at least credit quality step 2 in accordance with Article 129(4), the equivalent credit quality step in the event of a short term credit assessment or, in the absence of a credit assessment, they are assigned a 20% risk weight in accordance with Article 129(5);

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(vi) the cover pool meets at all times an asset coverage requirement of at least 7% in excess of the amount required to meet the claims attaching to the covered bonds. However, where covered bonds with a credit quality step 1 credit assessment do not meet the minimum issue size for extremely high quality covered bonds in accordance with paragraph 86(1)(f)(iv) but meet the requirements for high quality covered bonds in sub-paragraphs (i), (ii), (iii) and (iv), they must instead be subject to a minimum asset coverage requirement of 2%;

(d) exposures in the form of covered bonds issued by credit institutions in third countries, which comply with all of the following requirements–

(i) they are covered bonds in accordance with the national law of the third country which must define them as debt securities issued by credit institutions, or by a wholly owned subsidiary of a credit institution which guarantees the issue, and secured by a cover pool of assets, in respect of which bondholders must have direct recourse for the repayment of principal and interest on a priority basis in the event of the issuer's default;

(ii) the issuer and the covered bonds are subject by the national law in the third country to special public supervision designed to protect bondholders and the supervisory and regulatory arrangements applied in the third country must be at least equivalent to those applied in Gibraltar;

(iii) the covered bonds are backed by a pool of assets of one or more of the types described in Article 129(1)(b), (d)(i), (f)(i) or (g). Where the pool comprises loans secured by immovable property, the requirements in Articles 208 and 229(1) must be met;

(iv) the exposures to institutions in the cover pool meet the conditions laid down in Article 129(1)(c) or, where the GFSC has granted the partial waiver referred to in the last sub-paragraph of Article 129(1), the conditions referred to in that sub-paragraph;

(v) the credit institution investing in the covered bonds and the issuer meet the transparency requirement laid down in Article 129(7);

(vi) the covered bonds are assigned a credit assessment by a nominated ECAI which is at least credit quality step 1 in accordance with Article 129(4), the equivalent credit quality step in the event of a short term credit assessment or, in the absence of a credit assessment, they are assigned a 10% risk weight in accordance with Article 129(5); and

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(vii) the cover pool meets at all times an asset coverage requirement of at least 7% in excess of the amount required to meet the claims attaching to the covered bonds. However, where the issue size of the covered bonds is £440 million (or the equivalent amount in domestic currency) or higher, they must instead be subject to a minimum asset coverage requirement of 2%;

(e) corporate debt securities which meet all of the following requirements–

(i) they are assigned a credit assessment by a nominated ECAI which is at least credit quality step 1 in accordance with Article 122 or the equivalent credit quality step in the event of a short term credit assessment;

(ii) the securities issue size is at least £220 million (or the equivalent in domestic currency);

(iii) the maximum time to maturity of the securities at the time of issuance is 10 years;

(2) The market value of each of the level 2A assets must be subject to a haircut of at least 15%.

Level 2B assets.

88.(1) Level 2B assets must only include assets falling under one or more of the following categories and in each case meeting the specified eligibility criteria–

(a) exposures in the form of asset-backed securities meeting the requirements in paragraph 89;

(b) corporate debt securities which meet all of the following requirements–

(i) they have received a credit assessment by a nominated ECAI which is at least credit quality step 3 in accordance with Article 122 or the equivalent credit quality step in the event of a short term credit assessment;

(ii) the securities issue size is at least £220 million (or the equivalent in domestic currency);

(iii) the maximum time to maturity of the securities at the time of issuance is 10 years;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(c) shares which meet all of the following requirements–

(i) they form part of the Financial Times Stock Exchange 100 (FTSE 100) in the United Kingdom or a major stock index of a third country composed of leading companies in the relevant jurisdiction;

(ii) they are denominated in sterling or, where denominated in a different currency, they count as level 2B only up to the amount to cover stressed net liquidity outflows in that currency or in the jurisdiction where the liquidity risk is taken; and

(iii) they have a proven record as a reliable source of liquidity at all times, including during stress periods, which is considered to be met where during a 30 day calendar day market stress period–

(aa) the level of decline in the share's stock price did not exceed 40%; or

(bb) the increase in its haircut did not exceed 40 percentage points;

(d) restricted-use committed liquidity facilities that may be provided by the central bank or the central bank of a third country, if the requirements in paragraph 90 are met;

(e) exposures in the form of high quality covered bonds which comply with all of the following requirements–

(i) they are CRR covered bonds or meet the requirements to be eligible for the treatment set out in Article 129(4) or (5);

(ii) the credit institution investing in the covered bonds meets the transparency requirement in Article 129(7);

(iii) the issuer of the covered bonds makes the information referred to in Article 129(7)(a) available to investors on at least a quarterly basis;

(iv) their issue size is at least £220 million (or the equivalent amount in domestic currency);

(v) the covered bonds are collateralised exclusively by the assets referred to in Article 129(1)(a) and (d)(i);

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(vi) the pool of underlying assets consists exclusively of exposures which qualify for a 35% or lower risk weight under Article 125 for credit risk;

(vii) the cover pool meets at all times an asset coverage requirement of at least 10% in excess of the amount required to meet the claims attaching to the covered bonds;

(viii) the issuing credit institution needs to publicly disclose on a monthly basis that the cover pool meets the 10% asset coverage requirement;

(f) for credit institutions which in accordance with their statutes of incorporation are unable for reasons of religious observance from holding interest bearing assets, non-interest bearing assets constituting a claim on or guaranteed by central banks or by the central government or the central bank of a third country or by a regional government, local authority or public sector entity in a third country, if those assets have a credit assessment by a nominated ECAI of at least credit quality step 5 in accordance with Article 114, or the equivalent credit-quality step in the event of a short-term credit assessment.

(2) The market value of each of the level 2B assets must be subject to the following minimum haircuts–

(a) the applicable haircut set out in paragraph 89(7) for level 2B securitisations;

(b) a 50% haircut for corporate debt securities referred to in sub-paragraph (1)(b);

(c) a 50% haircut for shares referred to in sub-paragraph (1)(c);

(d) a 30% haircut for covered bond programmes or issues referred to in sub-paragraph (1)(e);

(e) a 50% haircut for non-interest bearing assets referred to in sub-paragraph (1)(f).

(3) Credit institutions which, in accordance with their statutes of incorporation, are unable for reasons of religious observance to hold interest bearing assets may, with the GFSC's approval, derogate from sub-paragraph (1)(b)(ii) and (iii) if there is evidence of insufficient availability of non-interest bearing assets meeting these requirements and the non-interest bearing assets in question are adequately liquid in private markets.

(4) In determining whether the non-interest bearing assets are adequately liquid for the purposes of the first subparagraph, the GFSC must consider the following factors–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) the available data in respect of their market liquidity, including trading volumes, observed bid-offer spreads, price volatility and price impact; and

(b) other factors relevant to their liquidity, including the historical evidence of the breadth and depth of the market for those non-interest bearing assets, the number and diversity of market participants and the presence of a robust market infrastructure.

Level 2B securitisations.

89.(1) Exposures in the form of asset-backed securities, as referred to in paragraph 88(1)(a), qualify as level 2B securitisations where the following conditions are satisfied–

(a) the designation "simple, transparent and standardised" or "STS", or a designation that refers directly or indirectly to those terms, is permitted to be used for the securitisation in accordance with the Securitisation Regulation and is being so used;

(b) the criteria in sub-paragraphs (2) to (6) are met.

(2) The securitisation position and the exposures underlying the position must meet all the following requirements–

(a) the position has been assigned a credit assessment of credit quality step 1 by a nominated ECAI in accordance with Article 264 or the equivalent credit quality step in the event of a short-term credit assessment;

(b) the position is in the most senior tranche or tranches of the securitisation and possesses the highest level of seniority at all times during the ongoing life of the transaction. For these purposes, a tranche must be considered to be the most senior where after the delivery of an enforcement notice and where applicable an acceleration notice, the tranche is not subordinated to other tranches of the same securitisation transaction or scheme in respect of receiving principal and interest payments, without taking account of amounts due under interest rate or currency derivative contracts, fees or other similar payments in accordance with Article 242(6);

(c) the securitisation position is backed by a pool of underlying exposures and those underlying exposures either all belong to only one of the following subcategories or else they consist of a combination of residential loans referred to in sub-paragraph (i)–

(i) residential loans secured with a first-ranking mortgage granted to individuals for the acquisition of their main residence, where one of the two following conditions is met–

(aa) the loans in the pool meet on average the loan-to-value requirement in Article 129(1)(d)(i);

(bb) the law of the jurisdiction where the loans were originated provides for a loan-to-income limit on the amount that an obligor may borrow in a residential loan. The loan-to-income limit is calculated on the gross annual income of the obligor, taking account of the tax obligations and other commitments of the obligor and the risk of changes in the interest rates over the term of the loan. For each residential loan in the pool, the percentage of the obligor's gross income that may be spent to service the loan, including interest, principal and fee payments, does not exceed 45%;

(ii) commercial loans, leases and credit facilities to undertakings established in Gibraltar to finance capital expenditures or business operations other than the acquisition or development of commercial real estate, where at least 80% of the borrowers in the pool in terms of portfolio balance are small and medium-sized enterprises at the time of issuance of the securitisation, and none of the borrowers is an institution as defined in Article 4(1);

(iii) auto loans and leases to borrowers or lessees established or resident in Gibraltar. For these purposes, auto loans and leases include loans or leases for the financing of motor vehicles or trailers, agricultural or forestry tractors, two-wheel motorcycles or powered tricycles or tracked vehicles. Such loans or leases may include ancillary insurance and service products or additional vehicle parts, and in the case of leases, the residual value of leased vehicles. All loans and leases in the pool must be secured with a first-ranking charge or security over the vehicle or an appropriate guarantee in favour of the SSPE, such as a retention of title provision;

(iv) loans and credit facilities to individuals resident in Gibraltar for personal, family or household consumption purposes.

(3) The underlying exposures must not have been originated by the credit institution holding the securitisation position in its liquidity buffer, its subsidiary, its parent undertaking, a subsidiary of its parent undertaking or any other undertaking closely linked with that credit institution.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(4) The issue size of the tranche must be at least £88 million (or the equivalent amount in domestic currency).

(5) The remaining weighted average life of the tranche must be 5 years or less, which must be calculated using the lower of either the transaction's pricing prepayment assumption or a 20% constant prepayment rate, for which the credit institution must assume that the call is exercised on the first permitted call date.

(6) The originator of the exposures underlying the securitisation must be an institution as defined in Article 4(1) or an undertaking whose principal activity is to pursue one or more of the activities listed in paragraphs 2 to 12 and 15 of the Schedule to the CICR Regulations.

(7) The market value of level 2B securitisations must be subject to the following minimum haircuts–

(a) 25% for securitisations backed by the subcategories of assets referred to in sub-paragraph (2)(c)(i) and (iii);

(b) 35% for securitisations backed by the subcategories of assets referred to in sub-paragraph (2)(c)(ii) and (iv).

Restricted-use committed liquidity facilities.

90. In order to qualify as level 2B assets, the restricted-use committed liquidity facilities that may be provided by a central bank as referred to in paragraph 88(1)(d) must fulfil all of the following criteria–

(a) during a non-stress period, the facility is subject to a commitment fee on the total committed amount which is at least the greater of the following–

(i) 75 basis points per annum; or

(ii) at least 25 basis points per annum above the difference in yield on the assets used to back the facility and the yield on a representative portfolio of liquid assets, after adjusting for any material differences in credit risk;

During a stress period, the central bank may reduce the commitment fee described in this sub-paragraph, if the minimum requirements applicable to liquidity facilities under the alternative liquidity approaches in accordance with paragraph 94 are met;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(b) the facility is backed by unencumbered assets of a type specified by the central bank. The assets provided as collateral must fulfil all of the following criteria–

(i) they are held in a form which facilitates their prompt transfer to the central bank in the event of the facility being called;

(ii) their value post-haircut as applied by the central bank is sufficient to cover the total amount of the facility;

(iii) they are not to be counted as liquid assets for the purposes of the credit institution's liquidity buffer;

(c) the facility is compatible with the counterparty policy framework of the central bank;

(d) the commitment term of the facility exceeds the 30 calendar day stress period referred to in paragraph 80;

(e) the facility is not revoked by the central bank prior to its contractual maturity and no further credit decision is taken for as long as the credit institution concerned continues to be assessed as solvent;

(f) there is a formal policy published by the central bank stating its decision to grant restricted-use committed liquidity facilities, the conditions governing the facility and the types of credit institutions that are eligible to apply for those facilities.

CIUs.

91.(1) Shares or units in CIUs qualify as liquid assets of the same level as the liquid assets underlying the relevant undertaking up to an absolute amount of £440 million (or equivalent amount in domestic currency) for each credit institution on an individual basis, if–

(a) the requirements in Article 132(3) are complied with;

(b) the CIU invests only in liquid assets and derivatives, in the latter case only to the extent necessary to mitigate interest rate, currency or credit risk in the portfolio.

(2) Credit institutions must apply the following minimum haircuts to the value of their shares or units in CIUs depending on the category of underlying liquid assets–

(a) 0% for coins and banknotes and exposures to central banks referred to in paragraph 86(1)(b);

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(b) 5% for level 1 assets other than extremely high quality covered bonds;

(c) 12% for extremely high quality covered bonds referred to in paragraph 86(1)(f);

(d) 20% for level 2A assets;

(e) 30% for level 2B securitisations backed by the subcategories of assets referred to in paragraph 89(2)(c)(i) and (iii);

(f) 35% for level 2B covered bonds referred to in paragraph 88(1)(e);

(g) 40% for level 2B securitisations backed by the subcategories of assets referred to in paragraph 89(2)(c)(ii) and (iv); and

(h) 55% for level 2B corporate debt securities referred to in paragraph 88(1)(b), shares referred to in paragraph 88(1)(c) and non-interest bearing assets referred to in paragraph 88(1)(f).

(3) The approach referred to in sub-paragraph (2) must be applied as follows–

(a) where the credit institution is aware of the exposures underlying the CIU, it may look-through to those underlying exposures to assign them the appropriate haircut in accordance with sub-paragraph (2);

(b) where the credit institution is not aware of the exposures underlying the CIU, it must assume, for the purposes of determining the liquidity level of the underlying assets and for the purposes of assigning the appropriate haircut to those assets, that the CIU invests in liquid assets, up to the maximum amount allowed under its mandate, in the same ascending order as liquid assets are classified for the purposes of sub-paragraph (2), starting with the assets referred to in sub-paragraph (2)(h) and ascending until the maximum total investment limit is reached.

(4) Credit institutions must develop robust methodologies and processes to calculate and report the market value and haircuts for shares or units in CIUs. Where the exposure is not sufficiently material for a credit institution to develop its own methodologies and, in each case, the competent authority is satisfied that this condition has been met, a credit institution may only rely on the following third parties to calculate and report the haircuts for shares or units in CIUs–

(a) the depository institution of the CIU, if the CIU invests exclusively in securities and deposits all such securities at this depository institution; or

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(b) for other CIUs, the CIU management company, if the CIU management company meets the requirements in Article 132(3)(a).

The correctness of the calculations made by the depository institution or by the CIU management company when determining the market value and haircuts for shares or units in CIUs must be confirmed by an external auditor on at least an annual basis.

(5) Where a credit institution fails to comply with the requirements in sub-paragraph (4) in relation to shares or units in a CIU, it must cease to recognise them as liquid assets for the purposes of this Part, in accordance with paragraph 93.

Composition of the liquidity buffer by asset level.

92.(1) Credit institutions must comply at all times with the following requirements on the composition of their liquidity buffer–

(a) a minimum of 60% of the liquidity buffer is to be composed of level 1 assets;

(b) a minimum of 30% of the liquidity buffer is to be composed of level 1 assets excluding extremely high quality covered bonds referred to in paragraph 86(1)(f);

(c) a maximum of 15% of the liquidity buffer may be held in level 2B assets.

(2) The requirements set out in sub-paragraph (1) must be applied after adjusting for the impact on the stock of liquid assets of secured funding, secured lending or collateral swap transactions using liquid assets on at least one leg of the transaction where the transactions mature within 30 calendar days, after deducting any applicable haircuts, and the credit institution complies with the operational requirements in paragraph 84.

(3) Credit institutions must determine the composition of their liquidity buffer in accordance with the formulae in paragraph 113.

(4) Credit institutions may, with the GFSC's approval on a case-by-case basis, disapply the application of sub-paragraphs (2) and (3) in full or in part with respect to one or more secured funding, secured lending or collateral swap transactions with the central bank using liquid assets on at least one leg of the transaction and maturing within 30 calendar days.

Breach of requirements.

93.(1) Where a liquid asset ceases to comply with any applicable general requirements in paragraph 83, the operational requirements in paragraph 84(2) or any applicable eligibility

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

criteria in this Chapter, the credit institution must cease to recognise it as a liquid asset no later than 30 calendar days from the date when the breach of requirements occurred.

(2) Sub-paragraph (1) applies to shares or units in a CIU ceasing to meet eligibility requirements only where they do not exceed 10% of the CIU's overall assets.

Alternative liquidity approaches.

94.(1) Where there are insufficient liquid assets in a given currency for credit institutions to meet the liquidity coverage ratio in paragraph 80, one or more of the following derogations may apply–

(a) the requirement on currency consistency set out in paragraph 84(6) may be disapplied in relation to that currency;

(b) the credit institution may cover the deficit of liquid assets in a currency with credit facilities from the central bank or the central banks of third countries of that currency, if the facility complies with all the following requirements–

(i) it is contractually irrevocably committed for the next 30 calendar days;

(ii) it is priced with a fee which is payable regardless of the amount, if any, drawn down against that facility;

(iii) the fee is set in an amount such that the net yield on the assets used to secure the facility must not be higher than the net yield on a representative portfolio of liquidity assets, after adjusting for any material differences in credit risk;

(c) where there is a deficit of level 1 assets but there are sufficient level 2A assets, the credit institution may hold additional level 2A assets in the liquidity buffer and the caps by asset level set out in paragraph 92 may be treated as amended accordingly. These additional level 2A assets must be subject to a minimum haircut equal to 20%. Any level 2B assets held by the credit institution remain subject to the haircuts applicable in each case in accordance with this Chapter.

(2) Credit institutions must apply the derogations in sub-paragraph (1) on an inversely proportional basis with regard to the availability of the relevant liquid assets. Credit institutions must assess their liquidity needs for the application of this paragraph, taking account of their ability to reduce, by sound liquidity management, the need for those liquid assets and the holdings of those assets by other market participants.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(3) The detailed conditions applicable to the use of the derogations in sub-paragraph (1)(a) and (b) must be determined in accordance with Part 5 of this Schedule.

TITLE 3
LIQUIDITY OUTFLOWS AND INFLOWS

CHAPTER 1
Net Liquidity outflows

Definition of net liquidity outflows.

95.(1) The net liquidity outflows must be the sum of liquidity outflows in paragraph (a) reduced by the sum of liquidity inflows in paragraph (b), but must not be less than zero, and must be calculated as follows–

(a) the sum of the liquidity outflows as defined in Chapter 2;

(b) the sum of liquidity inflows as defined in Chapter 3, calculated as follows–

(i) the inflows exempted from the cap as referred to in paragraph 109(2) and (3);

(ii) the lower of the inflows referred to in paragraph 109(4) and 90% of the outflows referred to in paragraph (a) reduced by the exempt inflows in paragraph 109(2) and (3), but not less than zero;

(iii) the lower of the inflows other than those referred to in paragraph 109(2), (3) and (4) and 75% of the outflows referred to in paragraph (a) reduced by the exempt inflows in paragraph 109(2) and (3) and the inflows in paragraph 109(4) divided by 0.9 to allow for the effect of the 90% cap, but not less than zero.

(2) Liquidity inflows and liquidity outflows must be assessed over a 30 calendar day stress period, under the assumption of a combined idiosyncratic and market-wide stress scenario as referred to in paragraph 81.

(3) The calculation in sub-paragraph (1) must be performed in accordance with the formula set out in paragraph 114.

Netting of derivatives transactions.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

96.(1) Credit institutions must calculate liquidity outflows and inflows expected over a 30 calendar day period, for the contracts listed in Schedule 2 and for credit derivatives, on a net basis by counterparty subject to the existence of bilateral netting agreements meeting the conditions in Article 295.

(2) Despite sub-paragraph (1), credit institutions must calculate cash outflows and inflows arising from foreign currency derivative transactions that involve a full exchange of principal amounts on a simultaneous basis (or within the same day) on a net basis, even where those transactions are not covered by a bilateral netting agreement.

(3) For the purposes of this paragraph net basis must be considered to be net of collateral to be posted or received in the next 30 calendar days. However, in the case of collateral to be received in the next 30 calendar days, net basis must be considered to be net of that collateral only if both of the following conditions are met–

(a) the collateral, when received, will qualify as a liquid asset under Title 2;

(b) the credit institution will be legally entitled and operationally able to reuse the collateral, when received.

CHAPTER 2
Liquidity outflows

Definition of liquidity outflows.

97.(1) Liquidity outflows must be calculated by multiplying the outstanding balances of various categories or types of liabilities and off-balance sheet commitments by the rates at which they are expected to run off or be drawn down as indicated in this Chapter.

(2) Liquidity outflows referred to in sub-paragraph (1) must include, in each case multiplied by the applicable outflow rate–

(a) the current outstanding amount for stable retail deposits and other retail deposits determined in accordance with paragraphs 99 and 100;

(b) the current outstanding amounts of other liabilities that become due, can be called for pay-out by the issuer or by the provider of the funding or entail an expectation by the provider of the funding that the credit institution would repay the liability during the next 30 calendar days determined in accordance with paragraphs 102, 103 and 107;

(c) the additional outflows determined in accordance with paragraph 105;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(d) the maximum amount that can be drawn down during the next 30 calendar days from undrawn committed credit and liquidity facilities determined in accordance with paragraph 106;

(e) the additional outflows identified in the assessment in accordance with paragraph 98.

(3) The calculation of liquidity outflows in accordance with sub-paragraph (1) must be subject to any netting of interdependent inflows that is approved under paragraph 101.

Additional liquidity outflows for other products and services.

98.(1) Credit institutions must regularly assess the likelihood and potential volume of liquidity outflows during 30 calendar days for products or services which are not referred to in paragraphs 102 to 107 and which they offer or sponsor or which potential purchasers would consider associated with them. Those products or services must include, but not be limited to–

(a) other off-balance-sheet and contingent funding obligations, including uncommitted funding facilities;

(b) undrawn loans and advances to wholesale counterparties;

(c) mortgage loans that have been agreed but not yet drawn down;

(d) credit cards;

(e) overdrafts;

(f) planned outflows related to the renewal of existing retail or wholesale loans or the extension of new retail or wholesale loans;

(g) derivative payables, other than the contracts listed in Schedule 2 and credit derivatives;

(h) trade finance off-balance-sheet related products.

(2) The outflows referred to in sub-paragraph (1) must be assessed under the assumption of a combined idiosyncratic and market-wide stress as referred to in paragraph 81. For that assessment, credit institutions must particularly take account of material reputational damage that could result from not providing liquidity support to such products or services.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Credit institutions must report at least once a year to the GFSC those products and services for which the likelihood and potential volume of the liquidity outflows referred to in sub-paragraph (1) are material and the institutions must assign appropriate outflows.

Outflows from stable retail deposits.

99.(1) Unless the criteria for a higher outflow rate under paragraph 100(2), (3) or (5) are fulfilled, the amount of retail deposits covered by the Gibraltar deposit guarantee scheme or an equivalent deposit guarantee scheme in a third country must be considered as stable and multiplied by 5% where the deposit is either–

(a) part of an established relationship making withdrawal highly unlikely; or

(b) held in a transactional account.

(2) For the purpose of sub-paragraph (1)(a) a retail deposit must be considered to be part of an established relationship where the depositor meets at least one of the following criteria–

(a) has an active contractual relationship with the credit institution of at least 12 months duration;

(b) has a borrowing relationship with the credit institution for residential loans or other long term loans;

(c) has at least one other active product, other than a loan, with the credit institution.

(3) For the purposes of sub-paragraph (1)(b) a retail deposit must be considered as being held in a transactional account where salaries, income or transactions are regularly credited and debited respectively against that account.

Outflows from other retail deposits.

100.(1) Credit institutions must multiply by 10% other retail deposits, including that part of retail deposits not covered by paragraph 99, unless the conditions in sub-paragraph (2) apply.

(2) Other retail deposits must be subject to higher outflow rates, as determined by the credit institution, in accordance with sub-paragraph (3), where the following conditions are met–

(a) the total deposit balance, including all the client's deposit accounts at that credit institution or group, exceeds £440,000;

(b) the deposit is an internet access-only account;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(c) the deposit offers an interest rate that fulfils any of the following conditions–

(i) the rate significantly exceeds the average rate for similar retail products;

(ii) its return is derived from the return on a market index or set of indices;

(iii) its return is derived from any market variable other than a floating interest rate;

(d) the deposit was originally placed as fixed-term with an expiry date maturing within the 30 calendar day period or the deposit presents a fixed notice period shorter than 30 calendar days, in accordance with contractual arrangements, other than those deposits that qualify for the treatment provided for in sub-paragraph (4);

(e) for credit institutions established in Gibraltar, the depositor is resident in a third country or the deposit is denominated in a currency other than sterling. For credit institutions or branches in third countries, the depositor is a non-resident in the third country or the deposit is denominated in another currency than the domestic currency of the third country;

(3) Credit institutions must apply a higher outflow rate determined as follows–

(a) where the retail deposits fulfil the criterion in sub-paragraph (2)(a) or two of the criteria in sub-paragraph (2)(b) to (e), an outflow rate of between 10% and 15% must be applied;

(b) where the retail deposits fulfil sub-paragraph (2)(a) and at least another criterion referred to in sub-paragraph (2), or three or more criteria of that sub-paragraph, an outflow rate of between 15% and 20% must be applied.

Credit institutions must apply the outflow rate referred to in sub-paragraph (3)(b) to retail deposits where the assessment referred to in sub-paragraph (2) has not been carried out or is not completed.

(4) Credit institutions may exclude from the calculation of outflows certain clearly circumscribed categories of retail deposits as long as in each and every instance the credit institution rigorously applies the following provisions for the whole category of those deposits, unless an exception can be justified on the basis of circumstances of hardship for the depositor–

(a) within 30 calendar days, the depositor is not allowed to withdraw the deposit; or

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(b) for early withdrawals within 30 calendar days, the depositor has to pay a penalty that includes the loss of interest between the date of withdrawal and the contractual maturity date plus a material penalty that does not have to exceed the interest due for the time that elapsed between the date of deposit and the date of withdrawal.

If a portion of the deposit can be withdrawn without incurring such a penalty, only that portion may be treated as a demand deposit and the remaining balance must be treated as a term deposit as referred to in this sub-paragraph. An outflow rate of 100% must be applied to cancelled deposits with a residual maturity of less than 30 calendar days and where pay-out has been agreed to another credit institution.

(5) Despite sub-paragraphs (1) to (4) and paragraph 99, credit institutions must multiply retail deposits that they have taken in third countries by a higher percentage outflow rate if such a percentage is provided for by the national law establishing liquidity requirements in that third country.

Outflows with inter-dependent inflows.

101. Subject to prior approval of the GFSC, credit institutions may calculate the liquidity outflow net of an interdependent inflow which meets all the following conditions–

(a) the interdependent inflow is directly linked to the outflow and is not considered in the calculation of liquidity inflows in Chapter 3;

(b) the interdependent inflow is required pursuant to a legal, regulatory or contractual commitment;

(c) the interdependent inflow meets one of the following conditions–

(i) it arises compulsorily before the outflow;

(ii) it is received within 10 days and is guaranteed by the government of Gibraltar.

Outflows from operational deposits.

102.(1) Credit institutions must multiply by 25% liabilities resulting from deposits that are maintained as follows–

(a) by the depositor in order to obtain clearing, custody, cash management or other comparable services in the context of an established operational relationship from the credit institution;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(b) by the depositor in the context of an established operational relationship other than that mentioned in paragraph (a).

(2) Despite sub-paragraph (1), credit institutions must multiply by 5% the portion of liabilities resulting from deposits referred to in sub-paragraph (1)(a) which is covered by the Gibraltar deposit guarantee scheme or an equivalent deposit guarantee scheme in a third country.

(3) Clearing, custody, cash management or other comparable services referred to in sub-paragraph (1)(a) only cover such services to the extent that they are rendered in the context of an established relationship which is critically important to the depositor. Deposits referred to in sub-paragraph (1)(a) and (b) must have significant legal or operational limitations that make significant withdrawals within 30 calendar days unlikely. Funds in excess of those required for the provision of operational services must be treated as non-operational deposits.

(4) Deposits arising out of a correspondent banking relationship or from the provision of prime brokerage services must not be treated as an operational deposit and must receive a 100% outflow rate.

(5) In order to identify the deposits referred to in sub-paragraph (1)(b), a credit institution must consider that there is an established operational relationship with a non-financial customer, excluding term deposits, savings deposits and brokered deposits, where all of the following criteria are met–

(a) the remuneration of the account is priced at least 5 basis points below the prevailing rate for wholesale deposits with comparable characteristics, but need not be negative;

(b) the deposit is held in specifically designated accounts and priced without creating economic incentives for the depositor to maintain funds in the deposit in excess of what is needed for the operational relationship;

(c) material transactions are credited and debited on a frequent basis on the account considered;

(d) one of the following criteria is met–

(i) the relationship with the depositor has existed for at least 24 months;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(ii) the deposit is used for a minimum of 2 active services. These services may include direct or indirect access to national or international payment services, security trading or depository services.

(6) Only that part of the deposit which is necessary to make use of the service of which the deposit is a by-product must be treated as an operational deposit. The excess must be treated as non-operational.

Outflows from other liabilities.

103.(1) Credit institutions must multiply liabilities resulting from deposits by clients that are non-financial customers, sovereigns, central banks, multilateral development banks, public sector entities, authorised credit unions, personal investment companies or by clients that are deposit brokers, to the extent they do not fall under paragraph 102 by 40%. However, where those liabilities are covered by the Gibraltar deposit guarantee scheme or an equivalent deposit guarantee scheme in a third country they must be multiplied by 20%.

(2) Credit institutions must multiply liabilities resulting from the institution's own operating expenses by 0%.

(3) Credit institutions must multiply liabilities maturing within 30 calendar days and resulting from secured lending or capital market-driven transactions, as defined in Article 192, by–

(a) 0% where they are collateralised by assets that, but for being used as collateral for those transactions, would qualify in accordance with paragraphs 83 and 86 as liquid assets of any of the categories of level 1 asset referred to in paragraph 86, with the exception of extremely high quality covered bonds referred to in paragraph 86(1)(f);

(b) 7% where they are collateralised by assets that, but for being used as collateral for those transactions, would qualify in accordance with paragraphs 83 and 86 as liquid assets of the category referred to in paragraph 86(1)(f);

(c) 15% where they are collateralised by assets that, but for being used as collateral for those transactions, would qualify in accordance with paragraphs 83 and 87 as liquid assets of any of the categories of level 2A asset referred to in paragraph 87;

(d) 25% where they are collateralised by assets that, but for being used as collateral for those transactions, would qualify in accordance with paragraphs 83 and 89 as liquid assets of any of the categories of level 2B asset referred to in paragraph 89(2)(c)(i) or (iii);

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(e) 30% where they are collateralised by assets that, but for being used as collateral for those transactions, would qualify in accordance with paragraphs 83 and 88 as liquid assets of the category of level 2B asset referred to in paragraph 88(1)(e);

(f) 35% where they are collateralised by assets that, but for being used as collateral for those transactions, would qualify in accordance with paragraphs 83 and 89 as liquid assets of any of the categories of level 2B asset referred to in paragraph 89(2)(c)(ii) or (iv);

(g) 50% where they are collateralised by assets that, but for being used as collateral for those transactions, would qualify in accordance with paragraphs 83 and 88 as liquid assets of any of the categories of level 2B asset referred to in paragraph 88(1) (b), (c) or (f);

(h) the percentage minimum haircut determined in accordance with paragraph 91(2) and (3) where they are collateralised by shares or units in CIUs that, but for being used as collateral for those transactions, would qualify in accordance with paragraphs 83 and 91 as liquid assets of the same level as the underlying liquid assets;

(i) 100% where they are collateralised by assets that do not fall within any of paragraphs (a) to (h).

(4) Despite sub-paragraph (3)–

(a) where the counterparty to the secured lending or capital market-driven transaction is the domestic central bank of the credit institution, the outflow rate must be 0%. However, in cases where the transaction is done through a branch with the central bank or the central bank of the third country in which the branch is located, a 0% outflow rate must be applied only if the branch has the same access to central bank liquidity, including during stress periods, as credit institutions incorporated in Gibraltar or that or third country have; and

(b) for secured lending or capital market-driven transactions that would require an outflow rate under higher than 25%, the outflow rate must be 25% where the counterparty to the transaction is an eligible counterparty.

(5) Collateral swaps, and other transactions with a similar form, that mature within the next 30 calendar days must lead to an outflow where the asset borrowed is subject to a lower haircut under chapter 2 than the asset lent the outflow must be calculated by multiplying the market value of the asset borrowed by the difference between the outflow rate applicable to the asset

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

lent and the outflow rate applicable to the asset borrowed determined in accordance with the rates specified in sub-paragraph (3). For the purposes of this calculation, a 100% haircut must be applied to assets that do not qualify as liquid assets.

(6) Despite sub-paragraph (5)–

(a) where the counterparty to the collateral swap or other transaction with a similar form is the domestic central bank of the credit institution, the outflow rate to be applied to the market value of the asset borrowed must be 0%. However, in cases where the transaction is done through a branch with the central bank or the central bank or of the third country in which the branch is located, a 0% outflow rate must be applied only if the branch has the same access to central bank liquidity, including during stress periods, as credit institutions incorporated in Gibraltar or that third country have; and

(b) for collateral swaps or other transactions with a similar form that would require an outflow rate higher than 25% under that first subparagraph, the outflow rate to be applied to the market value of the asset borrowed must be 25% where the counterparty is an eligible counterparty.

(7) The offsetting balances held in segregated accounts related to client protection regimes imposed by national regulations must be treated as inflows in accordance with paragraph 108 and must be excluded from the stock of liquid assets.

(8) Credit institutions must apply a 100% outflow rate to all notes, bonds and other debt securities issued by the credit institution, unless the bond is sold exclusively in the retail market and held in a retail account, in which case those instruments can be treated as the appropriate retail deposit category. Limitations must be placed such that those instruments cannot be bought and held by parties other than retail customers.

(9) Assets borrowed on an unsecured basis and maturing within the next 30 calendar days must be assumed to run off in full, leading to a 100% outflow of liquid assets, unless the credit institution owns the assets borrowed and the assets borrowed do not form part of the credit institution's liquidity buffer.

(10) For the purposes of this paragraph–

“domestic central bank” means the central bank or the central bank of the third country in which the credit institution is incorporated;

“eligible counterparty” means any of the following–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) the government of, or a public sector entity in, Gibraltar;

(b) the government of, or a public sector entity in, Gibraltar or the central government, a public sector entity, a regional government or a local authority of the third country in which the credit institution is incorporated for the transactions undertaken by that credit institution;

(c) a multilateral development bank;

but public sector entities, regional governments and local authorities must only count as an eligible counterparty where they are assigned a risk weight of 20% or lower in accordance with Article 115 or Article 116, as applicable.

Outflows within a group.

104.(1) Despite paragraph 106 credit institutions may, with the GFSC's prior approval, apply a lower outflow rate on a case by case basis for undrawn credit or liquidity facilities where–

(a) the counterparty is the parent or subsidiary institution of the credit institution or another subsidiary of the same parent institution or linked to the institution by a common management relationship; and

(b) the credit institution and the counterparty are established in Gibraltar.

(2) A credit institution must ensure that the lower outflow rate permitted under sub-paragraph (1) does not fall below the inflow rate applied by the counterparty.

Additional outflows.

105.(1) Collateral other than cash and assets referred to in paragraph 86 which is posted by the credit institution for contracts listed in Schedule 2 and credit derivatives, must be subject to an additional outflow of 20%.

Collateral in assets referred to in paragraph 86(1)(f) which is posted by the credit institution for contracts listed in Schedule 2 and credit derivatives must be subject to an additional outflow of 10%.

(2) The credit institution must calculate and notify to the GFSC an additional outflow for all contracts entered into, the contractual conditions of which lead, within 30 calendar days and following a material deterioration of the credit institution's credit quality, to additional liquidity outflows or collateral needs. The credit institution must notify the GFSC of that outflow no later than the submission of the reporting in accordance with Article 415.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

Where the GFSC considers that outflow to be material in relation to the potential liquidity outflows of the credit institution, it must require the credit institution to add an additional outflow for those contracts corresponding to the additional collateral needs or cash outflows resulting from a material deterioration in the credit institution's credit quality corresponding to a downgrade in its external credit assessment of at least three notches. The credit institution must apply a 100% outflow rate to those additional collateral or cash outflows. The credit institution must regularly review the extent of this material deterioration in the light of what is relevant under the contracts that it has entered into and must notify the result of its review to the GFSC.

(3) The credit institution must add an additional outflow corresponding to collateral needs that would result from the impact of an adverse market scenario on the credit institution's derivatives transactions if material. This calculation must be made in accordance with Part 7 of this Schedule.

(4) Outflows and inflows expected over 30 calendar days from the contracts listed in Schedule 2 and from credit derivatives must be taken into account on a net basis in accordance with paragraph 96. In the case of a net outflow, the credit institution must multiply the result by a 100% outflow rate. Credit institutions must exclude from such calculations those liquidity requirements that result from the application of sub-paragraphs (1), (2) and (3).

(5) Where the credit institution has a short position that is covered by an unsecured security borrowing, the credit institution must add an additional outflow corresponding to 100% of the market value of the securities or other assets sold short, unless the terms upon which the credit institution has borrowed them require their return only after 30 calendar days. Where the short position is covered by a collateralised securities financing transaction, the credit institution must assume the short position will be maintained throughout the 30 calendar day period and will receive a 0% outflow.

(6) The credit institution must add an additional outflow corresponding to 100% of–

(a) the excess collateral the credit institution holds that can be contractually called at any times by the counterparty;

(b) collateral that is due to be posted to a counterparty within 30 calendar days;

(c) collateral that corresponds to assets that would qualify as liquid assets for the purposes of Title 2 that can be substituted for assets corresponding to assets that would not qualify as liquid assets for the purposes of Title 2 without the consent of the credit institution.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(7) Deposits received as collateral must not be considered as liabilities for the purposes of paragraph 99, 100, 102, 103 or 107 but must be subject to the provisions of sub-paragraphs (1) to (6), where applicable. The amount of cash received exceeding the amount of cash received as collateral must be treated as deposits in accordance with paragraph 99, 100, 102, 103 or 107.

(8) Credit institutions must assume a 100% outflow for loss of funding on asset-backed securities, covered bonds and other structured financing instruments maturing within 30 calendar days, when these instruments are issued by the credit institution itself or by conduits or SPVs sponsored by the credit institution.

(9) Credit institutions must assume a 100% outflow for loss of funding on asset-backed commercial papers, conduits, securities investment vehicles and other such financing facilities. This 100% outflow rate must apply to the maturing amount or to the amount of assets that could potentially be returned or the liquidity required.

(10) For that portion of financing programs under sub-paragraphs (8) and (9), credit institutions that are providers of associated liquidity facilities do not need to double count the maturing financing instrument and the liquidity facility for consolidated programs.

(11) In relation to the provision of prime brokerage services, where a credit institution has covered the short sales of a client by internally matching them with the assets of another client and the assets do not qualify as liquid assets, those transactions must be subject to a 50% outflow rate for the contingent obligation.

Outflows from credit and liquidity facilities.

106.(1) For the purpose of this paragraph, a liquidity facility must be understood to mean any committed, undrawn back-up facility that would be utilised to refinance the debt obligations of a customer in situations where such a customer is unable to rollover that debt in financial markets. Its amount must be calculated as the amount of the debt issued by the customer currently outstanding and maturing within 30 calendar days that is backstopped by the facility. The portion of the liquidity facility that is backing a debt that does not mature within 30 calendar days must be excluded from the scope of the definition of the facility. Any additional capacity of the facility must be treated as a committed credit facility with the associated drawdown rate as specified in this paragraph. General working capital facilities for corporate entities will not be classified as liquidity facilities, but as credit facilities.

(2) Credit institutions must calculate outflows for credit and liquidity facilities by multiplying the amount of the credit and liquidity facilities by the corresponding outflow rates set out in sub-paragraphs (4) to (6). Outflows from committed credit and liquidity facilities must be determined as a percentage of the maximum amount that can be drawn down within

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

30 calendar days, net of any liquidity requirement that would be applicable under paragraph 98 for the trade finance off-balance sheet items and net of any collateral made available to the credit institution and valued in accordance with paragraph 85, where the collateral fulfils all of the following conditions–

(a) it may be reused or hypothecated by the credit institution;

(b) it is held in the form of liquid assets, but is not recognised as part of the liquidity buffer; and

(c) it does not consist in assets issued by the counterparty of the facility or one of its affiliated entities.

(3) If the necessary information is available to the credit institution, the maximum amount that can be drawn down for credit and liquidity facilities must be determined as the maximum amount that could be drawn down given the counterparty's own obligations or given the pre-defined contractual drawdown schedule coming due over 30 calendar days.

(4) The maximum amount that can be drawn down from undrawn committed credit facilities and undrawn committed liquidity facilities within the next 30 calendar days must be multiplied by 5% if they qualify for the retail deposit exposure class.

(5) The maximum amount that can be drawn down from undrawn committed credit facilities within 30 calendar days must be multiplied by 10% where they meet the following conditions–

(a) they do not qualify for the retail deposit exposure class;

(b) they have been provided to clients that are not financial customers, including non-financial corporates, sovereigns, central banks, multilateral development banks and public sector entities;

(c) they have not been provided for the purpose of replacing funding of the client in situations where the client is unable to obtain funding requirements in the financial markets.

(6) The maximum amount that can be drawn down from undrawn committed liquidity facilities within the next 30 calendar days must be multiplied by 30% where they meet the conditions referred to in sub-paragraph (5)(a) and (b), and by 40% when they are provided to personal investment companies.

(7) The undrawn committed amount of a liquidity facility that has been provided to an SSPE for the purpose of enabling that SSPE to purchase assets, other than securities, from clients

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

that are not financial customers must be multiplied by 10% to the extent that it exceeds the amount of assets currently purchased from clients and where the maximum amount that can be drawn down is contractually limited to the amount of assets currently purchased.

(8) The credit institution must multiply the maximum amount that can be drawn down from other undrawn committed credit and undrawn committed liquidity facilities within 30 calendar days by the corresponding outflow rate as follows–

(a) 40% for credit and liquidity facilities extended to credit institutions and for credit facilities extended to other regulated financial institutions, including insurance undertakings and investment firms, CIUs or non-open ended investment scheme;

(b) 100% for liquidity facilities that the credit institution has granted to SSPEs other than those referred to in sub-paragraph (7) and for arrangements under which the institution is required to buy or swap assets from an SSPE;

(c) 100% for credit and liquidity facilities to financial customers not referred to in paragraphs (a) and (b) and sub-paragraphs (1) to (7).

(9) Despite sub-paragraphs (1) to (8), credit institutions which have been set up and are sponsored by the government of Gibraltar may apply the treatments set out in sub-paragraphs (4) and (5) to credit and liquidity facilities that are extended to promotional lenders for the sole purpose of directly or indirectly funding promotional loans, if those loans meet the requirements for the outflow rates referred to in sub-paragraphs (4) and (5).

(10) Despite paragraph 108(3)(g), where those promotional loans are extended as pass through loans via another credit institution acting as an intermediary, a symmetric inflow and outflow may be applied by the credit institution acting as an intermediary. That inflow and outflow must be calculated by applying to the undrawn committed credit or liquidity facility received and extended the rate that is applicable to that facility by virtue of this sub-paragraph and respecting the conditions and requirements otherwise imposed in relation to it by this paragraph.

(11) The promotional loans referred to in sub-paragraphs (9) and (10) must be available only to persons who are not financial customers on a non-competitive, not for profit basis in order to promote the public policy objectives of the government of Gibraltar. It must only be possible to draw on such facilities following the reasonably expected demand for a promotional loan and up to the amount of such demand provided there is a subsequent reporting on the use of the funds distributed.

Outflows from liabilities and commitments not covered by other provisions of this Chapter.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

107.(1) Credit institutions must multiply by a 100% outflow rate any liabilities that become due within 30 calendar days, except for the liabilities referred to in paragraphs 99 to 106.

(2) Where the total of all contractual commitments to extend funding to non-financial customers within 30 calendar days, other than commitments referred to in paragraphs 99 to 106, exceeds the amount of inflows from those non-financial customers calculated in accordance with paragraph 108(3)(a), the excess must be subject to a 100% outflow rate. For the purposes of this sub-paragraph, non-financial customers must include, but not be limited to, individuals, SMEs, corporates, sovereigns, multilateral development banks and public sector entities, and must exclude financial customers and central banks.

CHAPTER 3
Liquidity inflows

Inflows.

108.(1) Liquidity inflows must be assessed over a period of 30 calendar days and must comprise only contractual inflows from exposures that are not past due and for which the credit institution has no reason to expect non-performance within 30 calendar days.

(2) Credit institutions must apply a 100% inflow rate to inflows referred to in sub-paragraph (1), including in particular the following inflows–

(a) monies due from central banks and financial customers with a residual maturity of no more than 30 calendar days;

(b) monies due from trade finance transactions referred to in paragraph (b) of the second sub-paragraph of Article 162(3) with a residual maturity of no more than 30 calendar days;

(c) monies due from securities maturing within 30 calendar days;

(d) monies due from positions in major indexes of equity instruments, provided there is no double counting with liquid assets. Those monies must include monies contractually due within 30 calendar days, such as cash dividends from those major indexes and cash due from those equity instruments sold but not yet settled, if they are not recognised as liquid assets in accordance with Title 2.

(3) Despite sub-paragraph (2), the inflows set out in this sub-paragraph must be subject to the following requirements–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) monies due from non-financial customers (within the meaning of paragraph 107(2)) with a residual maturity of no more than 30 calendar days, with the exception of monies due from those customers from trade finance transactions or maturing securities, must be reduced for the purposes of principal payment by 50% of their value.

However, credit institutions acting as intermediaries that have received a commitment as referred to in paragraph 106(10) from a credit institution set up and sponsored by the government of Gibraltar in order for them to disburse a promotional loan to a final recipient, or have received a similar commitment from a multilateral development bank or a public sector entity, may take an inflow into account up to the amount of the outflow that they apply to the corresponding commitment to extend those promotional loans;

(b) monies due from secured lending and capital market-driven transactions, as defined in Article 192, with a residual maturity of no more than 30 calendar days must be multiplied by–

(i) 0% where they are collateralised by assets that, whether or not they are re-used in another transaction, would qualify in accordance with paragraphs 83 and 86 as liquid assets of any of the categories of level 1 asset referred to in paragraph 86, with the exception of extremely high quality covered bonds referred to in paragraph 86(1)(f);

(ii) 7% where they are collateralised by assets that, whether or not they are re-used in another transaction, would qualify in accordance with paragraphs 83 and 86 as liquid assets of the category referred to in paragraph 86 (1)(f);

(iii) 15% where they are collateralised by assets that, whether or not they are re-used in another transaction, would qualify in accordance with paragraphs 83 and 87 as liquid assets of any of the categories of level 2A asset referred to in paragraph 87;

(iv) 25% where they are collateralised by assets that, whether or not they are re-used in another transaction, would qualify in accordance with paragraphs 83 and 89 as liquid assets of any of the categories of level 2B asset referred to in paragraph 89(2)(c)(i) or (iii);

(v) 30% where they are collateralised by assets that, whether or not they are re-used in another transaction, would qualify in accordance with paragraphs 83 and 88 as liquid assets of the category of level 2B asset referred to in paragraph 88(1)(e);

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(vi) 35% where they are collateralised by assets that, whether or not they are re-used in another transaction, would qualify in accordance with paragraphs 83 and 89 as liquid assets of any of the categories of level 2B asset referred to in paragraph 89(2)(c)(ii) or (iv);

(vii) 50% if they are collateralised by assets that, whether or not they are re-used in another transaction, would qualify in accordance with paragraphs 83 and 88 as liquid assets of any of the categories of level 2B asset referred to in paragraph 88(1)(b), (c) or (f);

(viii) the percentage minimum haircut determined in accordance with paragraph 91(2) and (3) if they are collateralised by assets that, whether or not they are re-used in another transaction, would qualify in accordance with paragraphs 83 and 91 as shares or units in CIUs of the same level as the underlying liquid assets;

(ix) 100% where they are collateralised by assets that do not fall within any of sub-paragraphs (i) to (viii).

However, no inflow must be recognised where the collateral is used by the credit institution to cover a short position in accordance with the second sentence of paragraph 105(5);

(c) monies due from contractual margin loans maturing in the next 30 calendar days made against non-liquid assets collateral may receive a 50% inflow rate. Those inflows may only be considered where the credit institution is not using the collateral it originally received against the loans to cover any short positions;

(d) monies due that the credit institution owing those monies treats in accordance with paragraph 102 must be multiplied by a corresponding symmetrical inflow rate. Where the corresponding rate cannot be established, a 5% inflow rate must be applied;

(e) collateral swaps, and other transactions with a similar form that mature within 30 calendar days must lead to an inflow where the asset lent is subject to a lower haircut under Chapter 2 than the asset borrowed. The inflow must be calculated by multiplying the market value of the asset lent by the difference between the inflow rate applicable to the asset borrowed and the inflow rate applicable to the asset lent in accordance with the rates specified in paragraph (b). For the purposes of this calculation, a 100% haircut must apply to assets that do not qualify as liquid assets;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(f) where the collateral obtained through reverse repos, securities borrowings, collateral swaps, or other transactions with a similar form, maturing within 30 calendar days is used to cover short positions that can be extended beyond 30 calendar days, the credit institution must assume that such reverse repos, securities borrowings, collateral swaps or other transactions with a similar form will be rolled-over and will not give rise to any cash inflows reflecting the need to continue to cover the short position or to repurchase the relevant securities. Short positions must include both instances where in a matched book the credit institution sold short a security outright as part of a trading or hedging strategy and instances where in a matched book the credit institution has borrowed a security for a given period and lent the security out for a longer period;

(g) undrawn credit or liquidity facilities, including undrawn committed liquidity facilities from central banks, and other commitments received, other than those referred to in paragraphs 106(10) and 110, must not be taken into account as an inflow;

(h) monies due from securities issued by the credit institution itself or by a SSPE with which the credit institution has close links must be taken into account on a net basis with an inflow rate applied on the basis of the inflow rate applicable to the underlying assets in accordance with this sub-paragraph;

(i) loans with an undefined contractual end date must be taken into account with a 20% inflow rate, provided that the contract allows the credit institution to withdraw or to request payment within 30 calendar days.

(4) Sub-paragraph (3)(a) does not apply to monies due from secured lending and capital market-driven transactions as defined in Article 192(2) and (3) that are collateralised by liquid assets in accordance with Title 2 as referred to in sub-paragraph (3)(b). Inflows from the release of balances held in segregated accounts in accordance with regulatory requirements for the protection of customer trading assets must be taken into account in full, if those segregated balances are maintained in liquid assets as defined in Title 2.

(5) Outflows and inflows expected over 30 calendar days from the contracts listed in Schedule 2 and from credit derivatives must be calculated on a net basis in accordance with paragraph 96 and must be multiplied by a 100% inflow rate in the event of a net inflow.

(6) Credit institutions must not take into account any inflows from any of the liquid assets referred to in Title 2 other than payments due on the assets that are not reflected in the market value of the asset.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(7) Credit institutions must not take into account inflows from any new obligations entered into.

(8) Credit institutions must take liquidity inflows which are to be received in third countries where there are transfer restrictions or which are denominated in non-convertible currencies into account only to the extent that they correspond to outflows respectively in the third country or currency in question.

Cap on inflows.

109.(1) Credit institutions must limit the recognition of liquidity inflows to 75% of total liquidity outflows as defined in Chapter 2 unless a specific inflow is exempted as referred to in sub-paragraphs (2), (3) or (4).

(2) A credit institution may apply for approval from the GFSC to fully or partially exempt the following liquidity inflows from the cap referred to in sub-paragraph (1) –

(a) inflows where the provider is a parent or a subsidiary of the credit institution or another subsidiary of the same parent or linked to the credit institution by a common management relationship;

(b) inflows from deposits placed with other credit institutions within a group of entities qualifying for the treatment set out in Article 113(6);

(c) inflows referred to in paragraph 101, including inflows from loans related to mortgage lending, or promotional loans referred to in paragraph 106(9) and (10) or from a multilateral development bank or a public sector entity that the credit institution has passed-through.

(3) A credit institutions may apply for approval from the GFSC to be exempted from the cap on inflows where the credit institution's–

(a) main activities are leasing and factoring business, but excluding the activities described in sub-paragraph (4);

(b) business activities exhibit a low liquidity risk profile; and

(c) ratio of main activities, as referred to in paragraph (a), exceeds 80% of its total balance sheet at an individual level.

(4) A credit institutions may apply for approval from the GFSC to be subject to a cap on inflows of 90% where the credit institution's–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) main activities are–

(i) financing for the acquisition of motor vehicles;

(ii) consumer credit within the meaning of the Financial Services (Consumer Credit) Act 2011.

(b) business activities exhibit a low liquidity risk profile; and

(c) ratio of main activities, as referred to in paragraph (a), exceeds 80% of its total balance sheet at an individual level.

(5) Credit institutions must disclose any exemption under sub paragraphs (3) and (4) in their annual report.

(6) The exemptions in sub-paragraphs (2), (3) and (4), when approved by the GFSC, may be applied at both the individual and consolidated levels subject to paragraph 78(3)(e).

(7) Credit institutions must determine the amount of the net liquidity outflows under the application of the inflow cap in accordance with the formula in paragraph 114.

Inflows within a group.

110. Despite paragraph 108(3)(g) credit institutions may, with the GFSC's prior approval, apply a higher inflow rate on a case by case basis for undrawn credit and liquidity facilities where–

(a) the counterparty is the parent or a subsidiary of the credit institution or another subsidiary of the same parent or linked to the credit institution by a common management relationship;

(b) the counterparty applies, by way of derogation from paragraph 106, a corresponding symmetric outflow rate to any inflow rate that exceeds 40%; and

(c) the credit institution and the counterparty are established in Gibraltar.

TITLE 5
FINAL PROVISIONS

Transitional provision: Government-guaranteed bank assets.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

111.(1) Assets issued by credit institutions which benefit from a guarantee from the government of Gibraltar qualify as level 1 assets only where the guarantee–

(a) was granted or committed to for a maximum amount prior to 30th June 2014;

(b) is a direct, explicit, irrevocable and unconditional guarantee and covers the failure to pay principal and interest when due.

(2) The assets referred to in sub-paragraph (1) continue to qualify as level 1 assets for as long as the guarantee remains in force in relation to the relevant issuer or its assets, as applicable, as amended or replaced from time to time. Where the amount of a guarantee in favour of an issuer or its assets is increased at any time after 30th June 2014, the assets only qualify as liquid assets up to the maximum amount of the guarantee that was committed prior to that date.

(3) The assets referred to in this paragraph are subject to the same requirements applicable under this Part to level 1 assets representing claims on or guaranteed by the central or regional governments, local authorities or public sector entities referred to in paragraph 86(1)(c).

(4) Where a credit institution or its assets benefit from a guarantee scheme, the scheme as a whole must be regarded as a guarantee for the purposes of this paragraph.

Transitional provision for securitisations backed by residential loans.

112. Despite paragraph 89, securitisations issued before 1st October 2015, where the underlying exposures are residential loans as referred to in paragraph 89(2)(c)(i), qualify as Level 2B assets if they meet all the requirements set out in paragraph 89 other than the loan-to-value or loan-to-income requirements in that point paragraph 89(2)(c)(i).

Formulae for the determination of the liquidity buffer composition.

113.(1) Credit institutions must use the following formulae to determine the composition of their liquidity buffer in accordance with paragraph 92.

Calculation of the liquidity buffer

(2) As of the calculation date, the liquidity buffer of the credit institution must be equal to–

(a) the level 1 asset amount; plus

(b) the level 2A asset amount; plus

(c) the level 2B asset amount;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

minus the lesser of–

(d) the sum of (a), (b), and (c); or

(e) the "excess liquid assets amount" as calculated in accordance with sub-paragraphs (3) and (4).

Excess liquid assets

(3) The excess liquid assets amount is comprised of the following components–

(a) the adjusted non-covered bond level 1 asset amount, which is equal to the value post-haircuts of all level 1 liquid assets, excluding level 1 covered bonds, that would be held by the credit institution upon the unwind of any secured funding, secured lending or collateral swap transaction that matures within 30 calendar days from the calculation date and where the credit institution and the counterparty exchange liquid assets on at least one leg of the transaction;

(b) the adjusted level 1 covered bond amount, which is equal to the value post-haircuts of all level 1 covered bonds that would be held by the credit institution upon the unwind of any secured funding, secured lending or collateral swap transaction that matures within 30 calendar days from the calculation date and where the credit institution and the counterparty exchange liquid assets on at least one leg of the transaction;

(c) the adjusted level 2A asset amount, which is equal to the value post-haircuts of all level 2A assets that would be held by the credit institution upon the unwind of any secured funding, secured lending or collateral swap transaction that matures within 30 calendar days from the calculation date and where the credit institution and the counterparty exchange liquid assets on at least one leg of the transaction; and

(d) the adjusted level 2B asset amount, which is equal to the value post-haircuts of all level 2B assets that would be held by the credit institution upon the unwind of any secured funding, secured lending or collateral swap transaction that matures within 30 calendar days from the calculation date and where the credit institution and the counterparty exchange liquid assets on at least one leg of the transaction.

Calculation of the excess liquid assets amount

(4) The excess liquid assets amount is equal to–

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(a) the adjusted non-covered bond level 1 asset amount; plus

(b) the adjusted level 1 covered bond amount; plus

(c) the adjusted level 2A asset amount; plus

(d) the adjusted level 2B asset amount;

minus the lesser of–

(e) the sum of (a),(b),(c) and (d);

(f) 100/30 times (a);

(g) 100/60 times the sum of (a) and (b);

(h) 100/85 times the sum of (a), (b) and (c).

Formula for the calculation of the net liquidity outflow.

114.(1) Net liquidity outflows equals total outflows less the reduction for fully exempt inflows less the reduction for inflows subject to the 90% cap less the reduction for inflows subject to the 75% cap.

(2) As a formula this may be expressed as–

NLO = TO – MIN(FEI, TO) – MIN(IHC, 0.9*MAX(TO – FEI, 0)) – MIN(IC,0.75*MAX(TO – FEI – IHC/0.9, 0))

where–

NLO = Net liquidity outflow;

TO = Total outflows;

TI = Total inflows;

FEI = Fully exempted inflows;

IHC = Inflows subject to higher cap of 90% outflows;

IC = Inflows subject to cap of 75% of outflows.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

PART 5
REQUIREMENTS SUPPLEMENTING THE APPLICATION OF DEROGATIONS CONCERNING CURRENCIES WITH CONSTRAINTS ON THE AVAILABILITY OF LIQUID ASSETS

Introduction.

115. This Part specifies the conditions for the application of the derogations in Article 419(2) concerning currencies with constraints on the availability of liquid assets.

Assessment of justified needs.

116. An institution must be considered to have justified needs for liquid assets for the purposes of Article 419(3) only where the following conditions are met–

(a) it has reduced, by sound liquidity management, the need for liquid assets in the full range of business conducted by the institution;

(b) its holdings of liquid assets are consistent with the availability of those assets in the relevant currency.

Application of derogation in Article 419(2)(a).

117.(1) An institution must take all reasonable steps to fulfil the liquidity coverage requirement set out in Article 412 before applying the derogation provided for in Article 419(2)(a).

(2) An institution must ensure that it is at all times able to operationally identify the liquid assets used to meet foreign currency liquidity coverage requirements and the liquid assets held as a result of the application of the derogation in Article 419(2)(a).

(3) An institution must ensure that its foreign exchange risk management framework meets the following conditions–

(a) currency mismatches resulting from the use of the derogation in Article 419(2)(a) are adequately measured, monitored, controlled and justified;

(b) liquid assets inconsistent with the distribution by currency of liquidity outflows after the deduction of inflows can be liquidated in sterling whenever necessary;

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(c) historical evidence relating to stress periods supports the conclusion that the institution is able to promptly liquidate the assets referred to in paragraph (b).

(4) An institution which uses liquid assets in a currency other than sterling to cover liquidity needs in sterling must apply a haircut of 8% to the value of those assets in addition to any haircut applied in accordance with Article 418.

(5) Where the liquid assets are denominated in a currency that is not actively traded in global foreign exchange markets, the additional haircut must be the higher of 8% and the largest monthly exchange rate movement between both currencies in the 10 years prior to the relevant reporting reference date.

Application of derogation in Article 419(2)(b.

118.(1) An institution must take all reasonable steps to fulfil the liquidity coverage requirement set out in Article 412 before applying the derogation provided for in Article 419(2)(b).

(2) An institution must obtain from the central bank in respect of the currency with constraints on the availability of liquid assets a credit line which complies with the following conditions–

(a) the credit line specifies that the institution has a legally binding entitlement to access the credit facilities and that entitlement is set out in a written agreement;

(b) following the decision to provide a credit line, access to the credit facilities is not subject to a credit decision by the central bank;

(c) the credit facilities can be drawn on by the institution without delay and no later than one day after giving notice to the central bank;

(d) the credit line is at all times available for a period exceeding the 30 day-period of the liquidity coverage requirement specified in Article 412(1).

(3) An institution must fully post collateral at the central bank, which, after being subject to any haircut applied by the central bank must at all times be equal to or greater than the maximum amount that may be drawn on the credit line.

Fee for granting a credit line.

119.(1) An institution must pay a fee established by the central bank, which is made up of two components for the credit line referred to in paragraph 118(2) and must ensure that there is no

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

economic advantage or disadvantage arising from the application of the derogation in Article 419(2)(b), when compared to institutions which do not apply the derogation.

(2) The fee to be paid by an institution for the credit line must be the sum of the following components–

(a) an amount which is based on the amount of the credit line drawn down;

(b) an amount which approximates the difference between the following–

(i) the yield on the assets used to secure the credit line;

(ii) the yield on a representative portfolio of assets of the type provided for in Article 416(1)(a) to (d).

(3) The amount referred to in sub-paragraph (2)(b) may be adjusted to take account of any material differences in credit risk between the sets of assets referred to in that sub-paragraph.

PART 6
REQUIREMENTS SUPPLEMENTING ADDITIONAL LIQUIDITY OUTFLOWS CORRESPONDING TO COLLATERAL NEEDS RESULTING FROM ADVERSE MARKET SCENARIO IMPACTS ON DERIVATIVES TRANSACTIONS

Materiality of an institution's derivatives transactions.

120.(1) An institution's derivatives transactions must be considered material for the purposes of the first sub-paragraph of Article 423(3) where the total of notional amounts of such transactions has exceeded 10% of the net liquidity outflows as referred to in Article 412(1) at any time in the previous two years.

(2) For the purposes of sub-paragraph (1), the net liquidity outflows must be calculated without the additional outflow component referred to in the first sub-paragraph of Article 423(3).

Calculation of an additional outflow corresponding to collateral needs resulting from the impact of an adverse market scenario on an institution's derivative transactions.

121.(1) The additional outflow corresponding to collateral needs resulting from the impact of an adverse market scenario on an institution's derivatives transactions considered as material in the application of paragraph 120 must be the largest absolute net 30-day collateral flow realised during the 24 months preceding the date of calculation of the liquidity coverage requirement referred to in Article 412(1).

© Government of Gibraltar (www.gibraltarlaws.gov.gi)

(2) Institutions may only treat inflows and outflows of transactions on a net basis where they are executed under the same master netting agreement.

(3) The absolute net collateral flow must be based on both realised outflows and inflows, and the netting must be calculated at the institution's portfolio level.

© Government of Gibraltar (www.gibraltarlaws.gov.gi)