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**Order N100/04 of the President of the National Bank of Georgia
Tbilisi, 28 October 2013**

**Regulation on Capital Adequacy Requirements
for Commercial Banks**

For the purpose of ensuring stable and sustainable functioning of the banking system of Georgia, reaching adequate capitalization of commercial banks to reduce the risk of defaults and for harmonization of the requirements with internationally accepted capital adequacy standards, pursuant to the subparagraph “g” of Article 15 and subparagraph “a” of paragraph 1 and paragraph 3 of Article 49 of the Organic law of Georgia on National bank of Georgia and Articles 9, 19 and 21 of the Law of Georgia on Activities of Commercial Banks, I hereby Order:

1. The approval of the regulation on Capital Adequacy Requirements for commercial banks with the attached annex.
2. This Order shall become effective upon its publication.

President of the National Bank of Georgia

Giorgi Kadagidze

Contents

Regulation on Capital Adequacy Requirements for Commercial Banks	5
Chapter I. General Provisions	5
Article 1. General Provisions	5
Article 2. Definition of Terms	5
Chapter II. Minimum Capital Requirements – Regulatory Capital (Pillar I) (Heading 18.12.2017 N175/04)	6
Article 3. Regulatory Capital	6
Article 4. Common Equity Tier 1 Capital	7
Article 5. Additional Tier 1 Capital	7
Article 6. Tier 2 Capital	7
Article 7. Regulatory Adjustments	8
Chapter III. Minimum Capital Requirements. Minimum Level of Regulatory Capital and Risk Weighted Exposures (Pillar I)	11
Article 8. Minimum Level of Regulatory Capital	11
Article 8 ¹ . Capital Conservation Buffer (18.12.2017 N175/04)	11
Article 8 ² . Countercyclical Capital Buffer (18.12.2017 N175/04)	11
Article 8 ³ . Systemicity Buffer (18.12.2017 N175/04)	12
Article 8 ⁴ . Combined Buffer Requirement (18.12.2017 N175/04)	12
Article 9. Calculation of Risk Weighted Exposures for Credit Risk (18.12.2017 N175/04)	13
Chapter IV. Minimum Capital Requirements. Calculation of Risk Weighted Exposures for Credit Risk. Standardized Approach (Pillar I) (Heading 18.12.2017 N175/04)	13
Article 10. Exposures	13
Article 11. Exposure Classes	13
Article 12. Calculation of Risk Weighted Exposures	14
Article 13. Calculation of Risk Weights to be Assigned to Risk Exposures	15
Article 14. Credit Quality Steps and Use of Credit Assessments	15
Chapter V. Minimum Capital Requirements. Calculation of Risk Weighted Exposures for Credit Risk. Credit Risk Mitigation (Pillar I) (Heading 18.12.2017 N175/04)	15
Article 15. Credit Risk Mitigation Allowed under the Standardized Approach	15
Article 16. Requirements for the Use of Credit Risk Mitigation	16
Article 17. Calculation of the Effect of Credit Risk Mitigation	16
Chapter VI. Removed (18.12.2017 N175/04)	17
Article 18. Removed (18.12.2017 N175/04)	17

Chapter VII. Minimum Capital Requirements. Calculation of Risk Weighted Exposures for Market Risk (Pillar I) (<i>Heading 18.12.2017 N175/04</i>).....	17
Article 19. Calculation of Risk Weighted Exposures for Market Risk.....	17
Chapter VIII. Minimum Capital Requirements. Calculation of Risk Weighted Exposures for Operational Risk (Pillar I) (<i>Heading 18.12.2017 N175/04</i>)	17
Article 20. Capital Calculation Methodology for Operational Risk	17
Chapter IX. Minimum Capital Requirements. Calculation of Risk Weighted Exposures for Operational Risk (Pillar I) (<i>Heading 18.12.2017 N175/04</i>)	18
Article 21. The Basic Indicator Approach	18
Article 22. The Standardized Approach.....	18
Chapter X. Commercial Banks' Internal Capital Adequacy Assessment Process (Pillar II) (<i>Heading 18.12.2017 N175/04</i>)	18
Article 23. Requirements for Internal Capital Adequacy Assessment Process (<i>18.12.2017 N175/04</i>) ..	18
Chapter XI. Supervisory Review and Evaluation Process and Capital Requirements under Pillar II (Pillar II) (<i>Heading 18.12.2017 N175/04</i>)	19
Article 24. Supervisory Review and Evaluation Process.....	19
Article 25. Supervisory Action and Pillar II Buffers (<i>18.12.2017 N175/04</i>).....	19
Chapter XII. Disclosure by Commercial Banks (Pillar III) (<i>15.08.2017 N120/04</i>).....	20
Article 26. Disclosure (<i>15.08.2017 N120/04</i>).....	20
Chapter XIII. Capital Definition	20
Article 27. Approval of the National Bank	20
Article 28. Criteria for Classification Instruments as Common Shares	20
Article 29. Criteria for Inclusion in Additional Tier 1 Capital	21
Article 30. Criteria for Inclusion in Tier 2 Capital.....	23
Chapter XIV. Classification of Off-balance -sheet Items	24
Article 31. Classification of Off-balance-sheet Items.....	24
Chapter XV. Standardized Approach. Risk Weights and Use of ECAIs' Credit Assessments	25
Article 32. Exposures to Central Governments or Central Banks	25
Article 33. Exposures to Regional Governments or Local Authorities	25
Article 34. Exposures to Public Sector Entities	26
Article 35. Exposures to Multilateral Development Banks	26
Article 36. Exposures to International Organizations/Institutions	27
Article 37. Exposures to Commercial Banks	27
Article 38. Exposures to Corporates	27

Article 39. Retail Exposures	28
Article 40. Exposures Secured by Mortgages on Residential Property	28
Article 41. Past Due Items	29
Article 42. Items Belonging to Regulatory High-risk Categories.....	30
Article 43. Short-term Exposures to Corporates (15.08.2017 N120/04).....	31
Article 44. Exposures in the Form of Collective Investment Undertakings (CIUs)	31
Article 45. Other Items	31
Article 46. Use of ECAIs' credit assessments for the determination of risk weights.....	32
Article 47. Issuer and Issue Credit Assessment	32
Article 48. Long-term and Short-term Credit Assessment.....	32
Article 49. Local and Foreign Currency Assessments	33
Chapter XVI. Counterparty Credit Risk	33
Article 50. Counterparty Credit Risk	33
Chapter XVII. Credit Risk Mitigation	33
Article 51. Eligibility	33
Article 52. Eligibility. Funded Credit Protection.....	33
Article 53. Eligibility. Unfunded Credit Protection	35
Article 54. Minimum Requirements	36
Article 55. Minimum Requirements. Funded Credit Protection	36
Article 56. Minimum Requirements. Unfunded Credit Protection	37
Article 57. Calculation of the Effects of Credit Risk Mitigation	38
Article 58. Calculation of the Effects of Credit Risk Mitigation. Funded Credit Protection.....	39
Article 59. Calculation of the Effect of Credit Risk Mitigation. Unfunded Credit Protection	40
Chapter XVIII. Operational Risk	41
Article 60. Calculating Capital Requirements for Operational risk using Basic Indicator Approach	41
Article 61. Calculating Capital Requirements for Operational risk using Standardized Approach.....	42
Chapter XIX. Transitional Provisions.....	43
Article 62. Transitional Provisions	43
Annex I	46
Annex II	49

Regulation on Capital Adequacy Requirements for Commercial Banks

Chapter I. General Provisions

Article 1. General Provisions

1. The aim of the represented regulation is to support, minimization of default risks of commercial banks and maintenance of financial stability of the whole banking system. National Bank of Georgia (hereinafter - the National Bank) shall ensure prevalence of efficient, transparent, and competitive environment in the banking sector and the protection of depositor and investor in a way that does not prevent accomplishment of its main task.
2. The main tool of banking supervision is to set minimum capital requirements and their monitoring.
3. This regulation sets out minimum capital requirements that are mandatory for every commercial bank and branches of foreign banks operating in Georgia.
4. The capital adequacy requirements as laid down in this Regulation are based on the three Pillars as defined by the internationally accepted capital adequacy framework of the “Basel committee on banking supervision”. If the regulation does not define any necessary instructions regulating specific questions or does not provide any definitions, with the approval of the National Bank, commercial banks should apply standards of the Basel Committee on Banking Supervision as well as Regulation No 575/2013 of the European Parliament and of the Council of 26 June 2013 and Directive 2013/36/EU. (18.12.2017 N175/04)

Article 2. Definition of Terms

Terms used in this Regulation have the following meanings:

- a) “General reserves”- unidentified loss reserve created on anticipated losses on loans and accrued interests receivables on loans, without their specification as defined by Regulation on Classification of assets and the loss provisioning by Commercial Banks approved by the Order of the President of the National Bank
- b) “Other comprehensive income” – other comprehensive income as defined by IFRS.
- c.) “Retained earnings” – retained earnings as defined by IFRS.
- d) “Intangible assets” – intangible assets as defined by IFRS.
- e) “Property, Plant and Equipment” – property, plant and equipment as defined by IFRS.
- f) “Cash flow hedge reserve” - cash flow hedge reserve as defined by IFRS.
- g) “Financial institutions” – representatives of financial sector as determined by the Organic Law of Georgia on the National Bank of Georgia and the law of Georgia on “The Securities market”..
- h) “Public sector entities” - Public entity, determined by the “Georgia’s General Administrative Code”, also according to this regulation administrative bodies responsible to central governments, regional governments or local authorities, or authorities that in the view of the competent authorities exercise the same responsibilities as regional and local authorities, or non-commercial legal entities owned by central governments of other countries that have explicit guarantee

arrangements, and may include self-administered bodies governed by law that are under public supervision may be considered as public entities;

i) “Funded credit protection” means a technique of credit risk mitigation where the reduction of the credit risk on the exposure of a commercial bank derives from the right of the commercial bank — in the event of the default of the counterparty or on the occurrence of other specified credit events relating to the counterparty to commence bankruptcy proceedings 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 commercial bank;

j) “Unfunded credit protection” means a technique of credit risk mitigation where the reduction of the credit risk on the exposure of a commercial bank derives from the undertaking of a third party to pay an amount in the event of the default of the borrower or on the occurrence of other specified credit events;

k) “Cash assimilated instrument” means a certificate of deposit or other similar instrument issued by the lending commercial bank;

l) “Group of connected clients” – group of connected clients as defined by Regulation of the Governor of NBG on Credit Concentration and Large Risks in Commercial Banks;

m) “Affiliate entity” - Subsidiaries and legal entities that are under control of the legal entity, also the controller bodies and their subsidiaries and the enterprises controlled by them;

n) “Regulatory consolidation” – Inclusion of the assets of an entity in which commercial bank has invested in the calculation of risk weighted assets;

o) “Exposure” - Asset or/and off-balance sheet element;

p) “Systemically important commercial bank” - a commercial bank determined by NBG the financial difficulties or other types of problems of which may cause a systemic risk; (18.12.2017 N175/04)

q) “Systemic risk” – risk to the stability of the financial system followed by important negative effects for the financial system and the actual economy; (18.12.2017 N175/04)

r) “Systemicity buffer” – additional capital requirement determined by NBG for systemically important commercial bank; (18.12.2017 N175/04)

s) “Risk weighted total exposure” – total of the exposures weighted against credit, market and operational risks; (18.12.2017 N175/04)

t) “Combined buffer requirement” – common equity Tier 1 capital required to meet the capital conservation, countercyclical and systemic buffer requirements. (18.12.2017 N175/04)

u) Sophisticated (experienced) investor – sophisticated (experienced) investor as defined by the the law of Georgia on “The Securities market”. (14.01.2020 N7/04)

v) Publicly held securities – publicly held securities as defined by the law of Georgia on “The Securities market”. (14.01.2020 N7/04)

Chapter II. Minimum Capital Requirements – Regulatory Capital (Pillar I)

(Heading 18.12.2017 N175/04)

Article 3. Regulatory Capital

1. The capital adequacy of a bank shall be determined on the basis of its regulatory Capital. None of its components or their part shall be a subject of an agreement, contract or a promise that contradict the stability and sustainability of a bank.

2. A bank's total Regulatory Capital will consist of the sum of the following elements:
 - a) Tier 1 Capital consisting of the following elements:
 - a.a) Common Equity Tier 1;
 - a.b) Additional Tier 1.
 - b) Tier 2 Capital (gone-concern capital).
3. Tier 1 capital consists of instruments that have the capacity to unconditionally absorb losses as they arise, allowing the bank to remain in business. The instruments, known as Tier 1 capital, must allow for fully discretionary payments, (such Tier 1 that non-payment is not an event of default) and for full principal loss absorption.
4. Tier 2 capital is a gone-concern capital which consists of instruments that have the capacity to absorb losses ahead of depositors and/or general creditors of the bank, but only in liquidation. Such instruments must be capable of either being written-off or converted into common equity at the point of non-viability.

Article 4. Common Equity Tier 1 Capital

1. A bank's Common Equity Tier 1 Capital shall be the primary source of the Regulatory Capital and shall equal the sum of Common Equity Tier 1 Capital elements less regulatory adjustments applied in the calculation of Common Equity Tier 1.
2. Common Equity Tier 1 Capital shall consist of the following elements:
 - a) Common shares which are fully paid in and that comply with the criteria provided in Chapter XIII of the represented regulation;
 - b) Stock surplus (share premium) resulting from the issue of instruments included in Common Equity Tier 1;
 - c) Accumulated other comprehensive income and other disclosed reserves;
 - d) Retained earnings (loss).

Article 5. Additional Tier 1 Capital

1. A bank's Additional Tier 1 Capital shall equal the sum of Additional Tier 1 Capital elements less regulatory adjustments applied in the calculation of Additional Tier 1 Capital.
2. Additional Tier 1 Capital consists of the sum of the following elements:
 - a) Instruments issued by the bank that meet the criteria listed in Chapter XIII of the represented regulation for inclusion in Additional Tier 1 Capital (and are not included in Common Equity Tier 1 Capital);
 - b) Stock surplus (share premium) resulting from the issue of instruments included in Additional Tier 1 Capital.

Article 6. Tier 2 Capital

1. Tier 2 Capital shall be the supplementary source of the Regulatory Capital and shall equal the sum of Tier 2 Capital elements less regulatory adjustments applied in the calculation of Tier 2 capital.

2. Tier 2 Capital consists of the sum of the following elements:
- a) Instruments issued by the bank that meet the criteria for inclusion in Tier 2 Capital listed in Chapter XIII of the represented regulation and are not included in Tier 1 Capital;
 - b) Stock surplus (share premium) resulting from the issue of instruments included in Tier 2 Capital;
 - c) General reserves, counting the mitigation effect, limited to a maximum of 1.25% of the bank's credit risk-weighted exposures. (15.08.2017 N120/04)

Article 7. Regulatory Adjustments

1. For the purpose of calculating capital adequacy, regulatory adjustment components as defined in this article shall be deducted from regulatory components. .
2. For the purpose of calculating regulatory capital the following adjustments shall be applied:
- a) Revaluation reserves on assets is to be deducted from Common Equity Tier 1;
 - b) Accumulated unrealized revaluation gains on assets (not only gains of the current year, but historically accumulated gains) through profit and loss to the extent that they exceed accumulated unrealized revaluation losses (only losses of the current year, but historically accumulated losses) through profit and loss is to be deducted from Common Equity Tier 1. The calculations should be performed for each asset classes given by four-digit codes under the "Guidelines on chart of accounts and their use for Georgian commercial banks". For the purpose of this subparagraph commercial banks shall not take into account high-quality liquid assets that are traded on liquid markets. The National Bank may require commercial banks not to qualify specific assets as high-quality liquid assets and deduct from capital accumulated gains that exceed accumulated losses from their revaluation.
 - c) Goodwill and other Intangible assets are to be deducted from Common Equity Tier 1. Such deductions are to be applied net of deferred tax liabilities; (15.08.2017 N120/04)
 - d) Deferred Tax Assets (DTA): Deferred tax assets (DTAs) that rely on future profitability of the commercial bank to be realized are to be deducted in the calculation of Common Equity Tier 1. Deferred tax assets may be netted with associated deferred tax liabilities (DTLs) only if the DTAs and DTLs relate to taxes levied by the same taxation authority and offsetting is permitted by the relevant taxation authority. Where these DTAs relate to temporary differences (e.g. allowance for credit losses) the amount to be deducted is set out in the "threshold deductions" Article 7 of this regulation, paragraph 3 below. All other such assets, e.g. those relating to operating losses, such as the carry forward of unused tax losses, or unused tax credits, are to be deducted in full, net of deferred tax liabilities as described above. The DTLs permitted to be netted against DTAs must exclude amounts that have been netted against the deduction of goodwill and other intangible assets, and must be allocated on a pro rata basis between DTAs subject to the threshold deduction treatment and DTAs that are to be deducted in full; (15.08.2017 N120/04)

- e) The amount of the cash flow hedge reserve that relates to the hedging of items that are not fair valued on the balance sheet (including projected cash flows) should be derecognized in the calculation of Common Equity Tier 1. Positive amounts should be deducted and negative amounts should be added back; this treatment specifically identifies the element of the cash flow hedge reserve that is to be derecognized for prudential purposes. It removes the element that gives rise to artificial volatility in common equity;
- f) Investments in own shares are to be deducted from regulatory capital, in particular all of a bank's investments in its own common shares, whether held directly or indirectly, will be deducted in the calculation of Common Equity Tier 1 Capital (unless already derecognized under the relevant accounting standards). In addition, any own stock which the commercial bank could be contractually obliged to purchase should be deducted in the calculation of Common Equity Tier 1 Capital. Commercial banks must deduct investments in their own Additional Tier 1 Capital in the calculation of their Additional Tier 1 Capital and must deduct investments in their own Tier 2 in the calculation of their Tier 2 Capital;
- g) Reciprocal cross holdings in the capital of commercial banks, insurance entities and other financial institutions are designed to artificially inflate the capital position of banks will be deducted in full. Commercial banks must apply a corresponding deduction approach to such investments in the capital of other banks, other financial institutions and insurance entities. This means the deduction should be applied to the same component of capital for which the capital would qualify if it was issued by the commercial bank itself. For the purpose of this subparagraph capital means Tier 1 and Tier 2 capital as defined under this regulation;
- h) Shortfall of the stock of provisions to the provisions based on the Asset Classification: The deduction from capital in respect of a shortfall of the stock of provisions to the provisions resulting from the Asset Classification as prescribed by NBG should be made in the calculation of Common Equity Tier 1. The full amount is to be deducted and should not be reduced by any tax effects that could be expected to occur if provisions were to rise to the level of expected losses;
- i) Investments in the capital of commercial banks, insurance entities and other financial institutions that are outside the scope of regulatory consolidation. For the purpose of this subparagraph capital means Tier 1 and Tier 2 capital as defined under this regulation. If the capital instrument of the given organization in which the commercial bank has invested does not meet the criteria for Common Equity Tier 1, Additional Tier 1, or Tier 2 capital of the bank as defined under Chapter XIII of the represented regulation, the capital is to be considered common shares (Common Equity Tier 1) for the purposes of this regulatory adjustment. If the investment is issued by the commercial bank and not included in regulatory capital, it must not be deducted;
- j) All investments included in subparagraph "I" of paragraph 2 of this Article that are not common shares must be fully deducted following a corresponding deduction approach. This means the deduction should be applied to the same tier of capital for which the capital would qualify if it was issued by the commercial bank itself. If the commercial

bank is required to make a deduction from a particular tier of capital and it does not have enough of that tier of capital to satisfy that deduction, the shortfall will be deducted from the next (higher) tier of capital;

- k) Holdings of equity and other participations constituting more than 10% of the share capital of other commercial legal entities should be deducted from Common Equity Tier 1 capital.

3. Investments that are common shares will be subject to the threshold treatment (threshold method):

- a) Instead of a full deduction, the following items may each receive limited recognition when calculating Common Equity Tier 1 Capital with recognition capped at 10% per item of the bank's Common Equity Tier 1 (after the application of all regulatory adjustments set out in subparagraphs "a" and "i" of paragraph 2) a.a) Significant investments as defined in subparagraph "i" of the represented Article 2 in the common shares of unconsolidated commercial banks insurance entities and other financial institutions where the commercial bank owns more than 10% of the issued common share capital of the issuing entity or where the entity is an affiliate of the bank; a.b) DTAs given in subparagraph "d", Article 2 of the represented regulation that arise from temporary differences;
- b) In addition, a commercial bank must deduct the amount by which the aggregate of the two items above exceeds 15% of its common equity component of Tier 1 (calculated prior to the deduction of these items but after application of all other regulatory adjustments applied in the calculation of Common Equity Tier 1);
- c) Investments in the common shares of unconsolidated commercial banks insurance entities and other financial institutions (given in subparagraph "i" of the represented Article 2) where the commercial bank owns less than 10% of the issued common share capital of the issuing entity should receive limited recognition: If the total of all holdings exceed 10% of the bank's common equity (after applying all other regulatory adjustments set out in subparagraphs "a" and "h" of paragraph then the amount above 10% is required to be deducted. The amount to be deducted from common equity should be calculated as the total of all holdings which in aggregate exceed 10% of the bank's common equity (as per above) multiplied by the common equity holdings as a percentage of the total capital holdings. Similarly, the amount to be deducted from Additional Tier 1 capital should be calculated as the total of all holdings which in aggregate exceed 10% of the bank's common equity multiplied by the Additional Tier 1 capital holdings as a percentage of the total capital holdings. The amount to be deducted from Tier 2 capital should be calculated as the total of all holdings which in aggregate exceed 10% of the bank's common equity multiplied by the Tier 2 capital holdings as a percentage of the total capital holdings.

Chapter III. Minimum Capital Requirements. Minimum Level of Regulatory Capital and Risk Weighted Exposures (Pillar I)

Article 8. Minimum Level of Regulatory Capital

1. Commercial banks are required to provide regulatory capital that is at all times more than or equal to the following minimum capital requirements:
 - a) Common Equity Tier 1 Capital ratio – a commercial bank's Common Equity Tier 1 Capital to Risk Weighted Exposures should be no less than 4.5% of the risk weighted exposures;
 - b) Total Tier 1 Capital ratio – a commercial bank's Tier 1 Capital to Risk Weighted Exposures should be no less than 6% of the risk weighted exposures;
 - c) Regulatory Capital Ratio – a bank's Regulatory Capital to Risk Weighted Exposures should be no less than 8% of the Risk Weighted Exposures.
2. The Risk Weighted Exposures as to be used for the calculation of the Common Equity Tier 1 ratio and the Regulatory Capital ratio are the sum of the Risk Weighted Exposures for Credit Risk, Market Risk and Operational Risk as defined in Chapters IV-XI of this Regulation.
3. For the purpose of calculating the abovementioned ratios commercial banks must use figures based on “Guidelines on chart of accounts and their use for Georgian commercial banks”.
4. **Removed** (18.12.2017 N175/04)
5. The National Bank may apply restriction to a commercial bank to issue and/or count in capital such instruments financed by a natural person that represent a liability for accounting purposes, in order to avoid excess granularity of the portfolio of such instruments. (10.03.2015 N27/04)

Article 8¹. Capital Conservation Buffer (18.12.2017 N175/04)

All banks must observe the capital conservation buffer at 2.5% for total risk weighted exposures in addition to the Pillar 1 minimum regulatory capital requirement determined by Article 8 of this regulation and the Pillar 2 capital buffers determined by Article 25.

Article 8². Countercyclical Capital Buffer (18.12.2017 N175/04)

1. Along with the requirements of Articles 8 and 8¹ and the Pillar 2 capital buffer under Article 25 of this regulation, the National Bank determines the requirement for all commercial banks to meet the countercyclical capital buffer.
2. Countercyclical capital buffer is calculated within the 0% to 2.5% range for total risk weighted exposures. In exceptional cases that must be confirmed by circumstances set out in paragraph three of this article, the countercyclical capital rate may exceed 2.5%. The buffer may be adjusted by 0.25 percentage points or its multiples.
3. The countercyclical buffer rate shall be reviewed quarterly and the analysis of the following factors shall be taken into account in the calculations: loans to GDP and relevant indicator of deviation from long-term trends, credit trends, other parameters of the cyclical position of the financial sector, financial stability indicators of domestic economies and companies, indicators of the internal and external macrofinancial standing of the country, etc.

4. If a countercyclical capital buffer is increased, commercial banks shall observe such buffer within 1 year after such increase, while in case of a decrease – immediately. In exceptional cases, that must be confirmed by circumstances set out in paragraph three of this article, the increased countercyclical buffer may be effective within less than a year.

5. The decision made in relation to a countercyclical capital buffer shall be published on the website of the National Bank with at least the rate of the countercyclical buffer, its effective date and the grounds for the decision shall be included.

Article 8³. Systemicity Buffer (18.12.2017 N175/04)

1. The National Bank shall determine systemically important commercial banks. In determining the systemically important banks, the banks' size in the banking system, connections with other banks, the ability to be replaced and complexity shall be taken into account.

2. Systemically important banks shall observe systemicity buffer within the rate for total risk weighted exposures in addition to the Pillar 1 minimum regulatory capital buffers determined by articles 8, 8¹ and 8² of this regulation and the Pillar 2 capital buffers determined by Article 25.

Article 8⁴. Combined Buffer Requirement (18.12.2017 N175/04)

1. Combined buffer, which is the sum of conservation, countercyclical and systemicity buffers, shall be observed through common equity Tier 1 elements.

2. If a commercial bank fails to observe the combined buffer requirement, the commercial bank shall be restricted distribution of common equity Tier 1 capital, payments towards instruments of additional Tier 1 capital instruments, producing flexible remuneration (bonus) payment obligations, and other payments determined by the National Bank for the period during which the bank fails to meet the combined buffer requirement.

3. Violation of the systemicity buffer requirement by a commercial bank (violation of the combined buffer exceeding ion volume the total volume of the conservation and the countercyclical buffers) shall lead to the application of stricter supervisory measures against the commercial bank in addition to those set out in paragraph 2 of Article 84.

4. In case of violation of the combined buffer requirement, the commercial bank, at identification of the violation of the buffer requirement, shall immediately notify and submit to the National Bank within five days a plan for covering the capital. In exceptional cases, depending on the volume of the activities of the commercial bank and complexity, the National Bank may extend the period up to 10 days.

5. The capital coverage plan shall contain the following:

- a) Assessment of financial parameters and forecast;
- b) Strategies of increasing capital coefficients;
- c) Plans and time periods for attracting the capital required to fully cover the combined buffer requirement;
- d) Additional information that the National Bank requires in order to assess the capital coverage plan.

6. The National Bank shall assess the submitted capital plan and find it acceptable only if, according to its assessment, the realization of the plan ensures that capital is maintained or

increase in a way to meet the combined buffer requirement within a reasonable time acceptable to the National Bank.

7. If, as a result of assessment by the National Bank, the capital plan is found to have failed to meet the requirements of paragraph 6 of this Article, the National Bank may:

- a) Request the commercial bank to cover within an indicated time frame the capital to a reasonable level that may exceed the minimum requirements determined by this regulation;
- b) Apply other sanctions as per the Law of Georgia on Commercial Bank Activity.

8. Before distribution of common equity Tier 1 capital elements, a commercial bank shall assess the result of such distribution on its capital adequacy indicator and insure that it is distributed in a way to avoid violating the combined buffer requirement.

Article 9. Calculation of Risk Weighted Exposures for Credit Risk (18.12.2017 N175/04)

For the purposes of the Articles 8-8³ of this regulation, commercial banks shall apply the Standardized Approach provided in Chapter IV and the methodology for FX induced Credit Risk.

Chapter IV. Minimum Capital Requirements. Calculation of Risk Weighted Exposures for Credit Risk. Standardized Approach (Pillar I) (Heading 18.12.2017 N175/04)

Article 10. Exposures

1. The exposure value of a balance-sheet items shall be the basic amount reduced after the special reserve and capital adjustments as per Article 7 of this regulation, relative accrued receivable interest and fines and any other types of requests towards a party, including any debit request, while the exposure value of an off-balance sheet item listed in Chapter XIV shall be the following percentage of its value reduced after the special reserve (credit-conversion factor): 100% if it is a full-risk item, 50% if it is a medium-risk item, 20% if it is a medium/low-risk item, 0% if it is a low-risk item. The off-balance sheet items referred to in the first sentence of this paragraph shall be assigned to risk categories as indicated in Chapter XIV of this regulation. (15.08.2017 N120/04)

2. The exposure value of a foreign-exchange or interest-rate derivative instrument that are subject to counterparty credit risk shall be determined in accordance with Chapter XVI.

3. Where an exposure is subject to funded credit protection, the exposure value applicable to that item may be modified in accordance with Chapter V of this regulation.

Article 11. Exposure Classes

1. Each exposure shall be assigned to one of the following exposure classes:

- a) Claims or contingent claims on central governments or central banks;
- b) Claims or contingent claims on regional governments or local authorities;

- c) Claims or contingent claims on public sector entities;
- d) Claims or contingent claims on multilateral development banks;
- e) Claims or contingent claims on international organizations/institutions;
- f) Claims or contingent claims on commercial banks;
- g) Claims or contingent claims on corporates;
- h) Retail claims or contingent retail claims;
- i) Claims or contingent claims secured by mortgages on residential property;
- j) Past due items;
- k) Items belonging to regulatory high-risk categories;
- l) Short-term claims on corporates;
- m) Claims in the form of collective investment undertakings ('CIU'); or
- n) Other items.

2. To be eligible for the retail exposure class referred to in subparagraph "h" of paragraph 1 of the represented Article:

- a) The exposure shall be either to an individual person or persons, or to a small or medium sized entity;
- b) The exposure shall be one of a significant number of exposures, no aggregate exposure to one counterpart exceeds 0.2% of the regulatory retail portfolio that qualifies and the exposures have similar characteristics such that the risks associated with such lending are substantially reduced;
- c) The total amount owed to the commercial bank by the obligor client (group of connected clients is meant) but excluding claims or contingent claims secured by residential property, shall not, exceed GEL 2,000,000. The commercial bank shall take reasonable steps to acquire this knowledge;
- d) Securities shall not be eligible for the retail exposure class.

3. The commercial banks will develop and have in place policies that ensure that all their exposures are identified and classified consistently and appropriately. In exposure classification policy, in allocating exposure class as per paragraph one of this Article, in case of standard exposures, the highest priority shall be assigned to exposures secured by residential real estate and the retail class pertaining to the following high supervisory exposures, while in case of all other categories of exposures, highest priority shall be assigned to the retail class pertaining to high supervisory exposure category. For standard as well as other categories of exposures, next level priority shall be assigned to the class of past due items. For the remaining exposures, priority shall be assigned to the class with the lowest exposure weight. In case an exposure falls under two classes, it shall be assigned to the class that has a lower exposure weight. An exposure can be divided into different exposure classes. (15.08.2017 N120/04)

Article 12. Calculation of Risk Weighted Exposures

1. To calculate risk-weighted exposure amounts, risk weights shall be applied to all exposures, unless deducted from regulatory capital, in accordance with the provisions of Articles 32 to 45 of the represented regulation. The application of risk weights shall be based on the exposure class to which the exposure is assigned and, to the extent specified in Articles 32 to 45 of the represented regulation its credit quality. Credit quality may be determined in reference to the credit assessments of External Credit Assessment Institutions (hereinafter, 'ECAIs') in accordance with the provisions of Articles 13 to 16. (18.12.2017 N175/04)

2. For the purposes of applying a risk weight, as referred to in paragraph 1, the exposure value shall be multiplied by the risk weight specified or determined in accordance with this chapter.
3. Notwithstanding the cases in which an exposure is subject to credit protection the risk weight applicable to that item may be modified in accordance with Chapter V. (18.12.2017 N175/04)

Article 13. Calculation of Risk Weights to be Assigned to Risk Exposures

1. The ECAI may be used to determine the risk weight of an exposure in accordance with Article 12 only if the ECAI which provides it has been recognized as eligible for those purposes by the National Bank (hereinafter 'an eligible ECAI').
2. The National Bank shall recognize an ECAI as eligible for the purposes of Article 13 only if they are satisfied that its assessment methodology complies with the requirements of objectivity, independence, ongoing review and transparency, and that the resulting credit assessments meet the requirements of credibility and transparency.
3. The list of eligible ECAIs recognized by the National Bank shall include the following: (25.08.2017 N81/04)
 - a) Fitch;
 - b) Moody's; and
 - c) Standard & Poor's.
4. A list of eligible ECAIs recognized by the National Bank shall be published on the National Bank official website. (25.08.2017 N81/04)

Article 14. Credit Quality Steps and Use of Credit Assessments

1. The National Bank shall determine with which of the credit quality steps set out in Articles 32 to 45 of this regulation the relevant credit assessments of an eligible ECAI are to be associated according to Annex N2. (25.08.2017 N81/04)
2. The use of ECAI credit assessments for the calculation of a commercial bank's risk-weighted exposure amounts shall be consistent and in accordance with Articles 46 to 49 of this regulation. Credit assessments shall not be used selectively.
3. Commercial banks shall use solicited credit assessments. However, with the permission of the National Bank, they may use unsolicited assessments.

Chapter V. Minimum Capital Requirements. Calculation of Risk Weighted Exposures for Credit Risk. Credit Risk Mitigation (Pillar I) (Heading 18.12.2017 N175/04)

Article 15. Credit Risk Mitigation Allowed under the Standardized Approach

1. For the purposes of this Chapter, lending commercial bank shall mean the commercial bank which has the exposure in question, whether or not deriving from a given loan.
2. Commercial banks using the Standardized Approach under Chapter IV may recognize credit risk mitigation in accordance with this Chapter in the calculation of risk-weighted exposure amounts for the purposes of Articles 8-8³ of this Regulation. (18.12.2017 N175/04)

Article 16. Requirements for the Use of Credit Risk Mitigation

1. The technique used to provide the credit protection together with the actions taken and procedures and policies implemented by the lending commercial bank shall be such as to result in credit protection arrangements which are legally effective and enforceable in all relevant jurisdictions.
2. The lending commercial bank shall take all appropriate steps to ensure the effectiveness of the credit protection arrangement and to address related risks.
3. In the case of funded credit protection, to be eligible for recognition the assets relied upon shall be 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. Eligibility shall be limited to the assets set out in Articles 51 to 53 of the represented regulation
4. In the case of funded credit protection, the lending commercial bank shall have the right to and/or retain, in a timely manner, the assets from which the protection derives in the event of the default, insolvency or bankruptcy of the obligor. The degree of correlation between the value of the assets relied upon for protection and the credit quality of the obligor shall not be undue.
5. In the case of unfunded credit protection, to be eligible for recognition the party giving the undertaking shall be sufficiently reliable, and the protection agreement 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. Eligibility shall be limited to the protection providers and types of protection agreement set out in Articles 51 to 53 of this regulation.
6. In order for the credit mitigation to be recognized as eligible the minimum requirements set out in Articles 54 to 56 shall be complied with.

Article 17. Calculation of the Effect of Credit Risk Mitigation

1. Where the requirements of Article 16 of this regulation are met the calculation of risk-weighted exposure amounts may be modified in accordance with Articles 57 to 59 of this regulation.
2. No exposure in respect of which credit risk mitigation is obtained shall produce a higher risk-weighted exposure amount than an otherwise identical exposure in respect of which there is no credit risk mitigation.
3. Where the risk-weighted exposure amount already takes account of credit protection the calculation of credit mitigation shall not be further recognized under this chapter.

Chapter VI. Removed (18.12.2017 N175/04)

Article 18. Removed (18.12.2017 N175/04)

Chapter VII. Minimum Capital Requirements. Calculation of Risk Weighted Exposures for Market Risk (Pillar I) (Heading 18.12.2017 N175/04)

Article 19. Calculation of Risk Weighted Exposures for Market Risk

1. For the purpose of this chapter only foreign exchange risk is considered as market risk.
2. The Risk Weighted exposures for foreign-exchange risk are equal to the consolidated overall open foreign currency position as defined in the “Regulation Setting, Calculating and Maintaining Overall Open Foreign Exchange Position Limit of Commercial Banks”.

Chapter VIII. Minimum Capital Requirements. Calculation of Risk Weighted Exposures for Operational Risk (Pillar I) (Heading 18.12.2017 N175/04)

Article 20. Capital Calculation Methodology for Operational Risk

1. The National Bank Commercial banks are required to maintain a minimum level of capital for operational risk.
2. The National Bank defines the method which the banks may use for operational risk capital calculation.
3. Depending on the size and complexity of the commercial bank, the commercial bank shall maintain capital for operational risk as set forth either in Article 21 or Article 22 of this regulation.
4. The risk weighted exposures for operational risk are determined by dividing the capital for operational risk by the Regulatory Capital requirement as defined in Article 8 of this regulation.
5. If the commercial bank is using the operational risk capital calculation method as defined by Article 22 of this regulation, the commercial bank is not allowed to revert back to or use the capital calculation method outlined in Article 21 of this regulation, without the consent of the National Bank.

Chapter IX. Minimum Capital Requirements. Calculation of Risk Weighted Exposures for Operational Risk (Pillar I) *(Heading 18.12.2017 N175/04)*

Article 21. The Basic Indicator Approach

1. Operational risk capital requirements for the basic indicator approach shall consist of a certain percentage of a relevant indicator as defined by the National Bank and which is in line with the parameters and criteria outlined in Article 60 of this regulation.

Article 22. The Standardized Approach

1. When using the standardized approach for operational risk, commercial banks shall divide their activities into several business lines as described in Article 61 of this regulation.
2. For each business line, commercial banks must calculate the operational risk capital requirement as a certain percentage of a relevant indicator that is determined by the National Bank and is in accordance with the conditions set forth in Article 61 of this regulation.
3. The operational risk capital requirement for the standardized approach consists of the sum of the individual capital requirements for each business line.
4. The requirements and parameters for the standardized approach are outlined in Article 61 of this regulation.
5. In order for the bank to be allowed to use the standardized approach for operational risk capital calculation, the commercial bank must meet the requirements and specifications as described in Article 61 of this regulation.

Chapter X. Commercial Banks' Internal Capital Adequacy Assessment Process (Pillar II) *(Heading 18.12.2017 N175/04)*

Article 23. Requirements for Internal Capital Adequacy Assessment Process

(18.12.2017 N175/04)

1. Along with the minimum regulatory capital requirements as per Article 8 of this regulation, commercial banks shall also observe additional capital buffer requirements for those risks that are not covered by Pillar I (including the market risks not covered by Pillar I, as well as concentration risks, interest rate, liquidity, strategic and reputational risks, etc.). In order to assess and respond to these risks and determine the sufficient internal capital adequacy level, commercial banks shall implement a sound, effective and comprehensive processes.
2. For the purposes of paragraph 1 of this Article, commercial banks shall have a sound management system that comprises a clearly defined organizational structure to ensure allocation of responsibilities, effective identification, management, monitoring and reporting of risks, adequate internal control mechanisms, including sound administration and accounting procedures, adequate informational technology and control for effective risk management, remuneration policies and procedures.

3. Within the Internal Capital Adequacy Assessment Process implemented in a commercial bank, a regular review of the implemented strategies and processes of a bank shall be carried out to ensure that they are comprehensive and appropriate for the type, volume of activity and complexity of a commercial bank.
4. Commercial banks shall report the outcome of their Internal Capital Adequacy Assessment Process at least once per year to the National Bank.
5. Commercial banks may use figures calculated based on IFRS for pillar II purposes.

Chapter XI. Supervisory Review and Evaluation Process and Capital Requirements under Pillar II (Pillar II) *(Heading 18.12.2017 N175/04)*

Article 24. Supervisory Review and Evaluation Process

1. The National Bank shall review the arrangements, strategies, processes and mechanisms implemented by the commercial banks to comply with this Regulation and evaluate the risks of commercial banks according to the Rule on General Risk Assessment Program for Commercial Banks approved by Order N32/04 dated 27 March 2014 of the President of the National Bank of Georgia. *(18.12.2017 N175/04)*
2. **Removed** *(18.12.2017 N175/04)*
3. Based on the outcomes of the review and evaluation under paragraph one of this Article, the National Bank shall determine whether the actions, strategies, processes and mechanisms, as well as the regulatory capital of a commercial bank ensures sound management of risks by the commercial bank and the ability to properly mitigate the risks it faces. *(18.12.2017 N175/04)*
4. The National Bank shall establish the frequency and intensity of the review and evaluation referred to in paragraph 1 of this Article having regard to the size, systemic importance, nature, scale and complexity of the activities of the commercial bank concerned and other important characteristics.

Article 25. Supervisory Action and Pillar II Buffers *(18.12.2017 N175/04)*

1. The National Bank shall require any commercial bank that does not meet the requirements of this regulation or as a response to the risks identified through the supervisory review and evaluation as per Article 24 of this regulation to take the necessary actions or steps at an early stage to address the situation. For those purposes, the measures available to the National Bank include the measures as laid down in the Law of Georgia on Activities of Commercial Banks, including obliging commercial banks to hold regulatory capital in excess of the minimum level as laid down in Article 8 of this regulation under Pillar II.
2. The National Bank shall elaborate a rule for determining capital buffers under Pillar II.

Chapter XII. Disclosure by Commercial Banks (Pillar III) (15.08.2017 N120/04)

Article 26. Disclosure (15.08.2017 N120/04)

For the purposes of this regulation, commercial banks shall publicly disclose the information as required by the “Regulation on Transparency of a Commercial Bank Financial Condition under Pillar III”.

Chapter XIII. Capital Definition

Article 27. Approval of the National Bank

1. The commercial banks need the National Bank approval to take into account any newly issued instruments into the calculation of the Regulatory Capital. The National Bank will consider the approval based on documentation to be provided by the commercial bank, which should explain clearly the compliance of the instrument with the criteria as described in the relevant paragraphs of this chapter.

Article 28. Criteria for Classification Instruments as Common Shares

1. Capital instruments should comply with the following criteria in order to be included in Common Equity Tier 1 Capital:

- a) Represents the most subordinated claim in case of liquidation of the commercial bank;
- b) Entitled to a claim on the residual assets that is proportional with its share of issued capital, after all senior claims have been repaid in liquidation Principal is perpetual and never repaid outside of liquidation (setting aside discretionary repurchases or other means of effectively reducing capital in a discretionary manner that is allowable under Georgian law);
- c) The commercial bank neither does anything to create an expectation at issuance that the instrument will be bought back, redeemed or cancelled nor does the statutory or contractual terms provide any feature which might give rise to such an expectation;
- d) Distributions are paid out of distributable items (retained earnings included). The level of distributions is not in any way tied or linked to the amount paid in at issuance and is not subject to a contractual cap (except to the extent that a commercial bank is unable to pay distributions that exceed the level of distributable items);
- e) There are no circumstances under which the distributions are obligatory. Non-payment is therefore not an event of default;
- f) Distributions are paid only after all legal and contractual obligations have been met and payments on more senior capital instruments have been made. This means that there are no preferential distributions, including in respect of other elements classified as the highest quality issued capital;

- g) It is the issued capital that takes the first and proportionately greatest share of any losses as they occur. Within the highest quality capital, each instrument absorbs losses on a going concern basis proportionately and *pari passu* with all the others;
- h) The paid in amount is recognized as equity capital and not recognized as a liability for determining balance sheet insolvency;
- i) The paid in amount is classified as equity under the relevant accounting standards;
- j) It is directly issued and paid-in and the commercial bank cannot directly or indirectly have funded the purchase of the instrument;
- k) The paid in amount is neither secured nor covered by a guarantee of the issuer or related entity or subject to any other arrangement that legally or economically enhances the seniority of the claim;
- l) It is only issued with the approval of the owners of the issuing bank, either given directly by the owners or, if permitted by the Law on Activities of Commercial Banks and the Law on Entrepreneurship, given by the Board of Directors or by other persons duly authorized by the owners;
- m) It is clearly and separately disclosed on the commercial bank's balance sheet.

Article 29. Criteria for Inclusion in Additional Tier 1 Capital

1. Capital instruments should comply with the following criteria in order to be included in Additional Tier 1 Capital:

- a) Issued and paid-in;
- b) Subordinated to depositors, general creditors and subordinated debt of the commercial bank;
- c) Is neither secured nor covered by a guarantee of the issuer or related entity or other arrangement that legally or economically enhances the seniority of the claim vis-à-vis bank creditors;
- d) Is perpetual, i.e. there is no maturity date and there are no step-ups or other incentives to redeem;
- e) May be callable at the initiative of the issuer only after a minimum of five years:
 - e.a) To exercise a call option a commercial bank must receive prior supervisory approval from; the National Bank
 - e.b) A commercial bank must not do anything which creates an expectation that the call will be exercised;
 - e.c) A commercial bank must not exercise a call unless: they replace the called instrument with capital of the same or better quality and the replacement of this capital is done at conditions which are sustainable for the income capacity of the bank; or the commercial bank demonstrates that its capital position is well above the minimum capital requirements after the call option is exercised.

- f) Any repayment of principal (e.g. through repurchase or redemption) must be with prior supervisory approval of the National Bank and commercial banks should not assume or create market expectations that supervisory approval of the National Bank will be given;
- g) Dividend/coupon:
 - g.a) The commercial bank must have full discretion at all times to cancel distributions/payments;
 - g.b) Cancellation of discretionary payments must not be an event of default;
 - g.c) A commercial bank must have full access to cancelled payments to meet obligations as they fall due;
 - g.d) Cancellation of distributions/payments must not impose restrictions on the commercial bank except in relation to distributions to common stockholders.
- h) Dividends/coupons must be paid out of distributable items;
- i) The instrument cannot have a credit sensitive dividend feature, that is a dividend/coupon that is reset periodically based in whole or in part on the banking organization's credit standing;
- j) The instrument cannot contribute to liabilities exceeding assets;
- k) Instruments classified as liabilities for accounting purposes must have principal loss absorption through either (i) conversion to common shares at an objective pre-specified trigger point or (ii) a write-down mechanism which allocates losses to the instrument at a pre-specified trigger point. The write-down will have the following effects:
 - k.a) Reduce the claim of the instrument in liquidation;
 - k.b) Reduce the amount to be re-paid when a call is exercised; and
 - k.c) Partially or fully reduce coupon/dividend payments on the instrument.
- l) Neither the commercial bank nor a related party over which the bank exercises control or significant influence can have purchased the instrument, nor can the commercial bank directly or indirectly have funded the purchase of the instrument;
- m) The instrument cannot have any features that hinder recapitalization, such as provisions that require the issuer to compensate investors if a new instrument is issued at a lower price during a specified time frame;
- n) The instrument financed by a natural person that represents a liability for accounting purposes, except publicly held securities, shall be included in the regulatory capital only in case the nominal contractual amount of the instrument is minimum GEL 1 000 000 (minimum nominal value in case of securities). Publicly held securities shall be included in the regulatory capital only in the case if this instrument is financed by the sophisticated (experienced) investor and the minimum contractual amount of the instrument or the minimum amount of each purchase agreement of this instrument is GEL 100 000 for each investor. (14.01.2020 N7/04)

Article 30. Criteria for Inclusion in Tier 2 Capital

1. Capital instruments should comply with the following criteria in order to be included in Tier 2 Capital:
 - a) Issued and paid-in;
 - b) Subordinated to depositors and general creditors of the bank;
 - c) Is neither secured nor covered by a guarantee of the issuer or related entity or other arrangement that legally or economically enhances the seniority of the claim vis-à-vis depositors and general creditors of commercial bank;
 - d) Maturity:
 - d.a) Minimum original maturity of at least five years;
 - d.b) Recognition in Regulatory Capital in the remaining five years before maturity will be amortized on a straight line basis;
 - d.c) There are no interest rate step-ups or other incentives to redeem.
 - e) May be callable at the initiative of the issuer only after a minimum of five years:
 - e.a) To exercise a call option a commercial bank must receive prior supervisory approval from the National Bank;
 - e.b) A commercial bank must not do anything which creates an expectation that the call will be exercised;
 - e.c) A commercial bank must not exercise a call unless they replace the called instrument with capital of the same or better quality and the replacement of this capital is done at conditions which are sustainable for the income capacity of the bank or the commercial bank demonstrates that its capital position is well above the minimum capital requirements after the call option is exercised;
 - f) The investor must have no rights to accelerate the repayment of future scheduled payments (coupon or principal), except in bankruptcy and liquidation; *(15.08.2017 N120/04)*
 - g) The instrument cannot have a credit sensitive dividend feature, that is a dividend/coupon that is reset periodically based in whole or in part on the banking organization's credit standing; *(15.08.2017 N120/04)*
 - h) Neither the bank nor a related party over which the bank exercises control or significant influence can have purchased the instrument, nor can the bank directly or indirectly have funded the purchase of the instrument; *(15.08.2017 N120/04)*
 - o) The instrument financed by a natural person that represents a liability for accounting purposes, except publicly held securities, shall be included in the regulatory capital only in case the nominal contractual amount of the instrument is minimum GEL 1 000 000 (minimum nominal value in case of securities). Publicly held securities shall be included in the regulatory capital only in the case if this instrument is financed by the sophisticated (experienced) investor and the minimum contractual amount of the instrument or the minimum amount of each purchase agreement of this instrument is GEL 100 000 for each investor. *(14.01.2020 N7/04)*

2. If the instrument is tranching, then each of them separately should satisfy the abovementioned criteria.

Chapter XIV. Classification of Off-balance -sheet Items

Article 31. Classification of Off-balance-sheet Items

1. Full risk (Where the instrument is a direct credit substitute and the credit risk is equivalent to that of an on-balance sheet exposure to the same counterparty and where the commercial bank is exposed to credit risk on total nominal value) category includes the following off-balance-sheet items:

- a) Guarantees having the character of credit substitutes;
- b) Credit derivatives;
- c) Acceptances;
- d) Endorsements on bills not bearing the name of another commercial bank;
- e) Transactions with recourse;
- f) Irrevocable standby letters of credit having the character of credit substitutes;
- g) Assets purchased under outright forward purchase agreements;
- h) The unpaid portion of partly-paid shares and securities;
- i) Asset sale and repurchase agreements; and
- j) Other items also carrying full risk and as communicated by the National Bank

2. Medium risk (where there is a significant credit risk but circumstances such as tying to realization of other transactions, etc. suggest less than full credit risk) category includes the following off-balance-sheet items:

- a) Documentary credits issued and confirmed;
- b) Warranties and indemnities (including tender, performance bonds) and guarantees not having the character of credit substitutes;
- c) Irrevocable standby letters of credit not having the character of credit substitutes;
- d) Undrawn credit facilities (agreements to lend, purchase securities, provide guarantees or acceptance facilities, credit cards and overdrafts) with an original maturity of more than one year; (15.08.2017 N120/04)
- e) Other items also carrying medium risk and as communicated by the National Bank

3. Medium/low risk (where mitigating self-liquidation and/or lower maturity circumstances suggest lower than medium risk) category includes the following off-balance-sheet items:

- a) Documentary credits in which underlying shipment acts as collateral and other self-liquidating transactions;
- b) Undrawn credit facilities (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;
and

c) Other items also carrying medium/low risk and as communicated by the National Bank

4. Low risk (Where credit risk can be ignored because different circumstances have significantly lowered it) category includes the following off-balance-sheet items:

a) Undrawn credit facilities (agreements to lend, purchase securities, provide guarantees or acceptance facilities) which may be cancelled unconditionally at any time without notice, and/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 commercial bank to cancel them to the full extent allowable under consumer protection and related legislation;

b) Other items also carrying low risk and as communicated by the National Bank.

Chapter XV. Standardized Approach. Risk Weights and Use of ECAIs' Credit Assessments

Article 32. Exposures to Central Governments or Central Banks

1. Without prejudice to paragraphs 2 to 3 of this Article, exposures to central governments and central banks shall be assigned a 100% risk weight.

2. Subject to paragraph 3, exposures to central governments and central banks for which a credit assessment by a nominated ECAI is available shall be assigned a risk weight according to Table 1 of Annex I of this regulation in accordance with the assignment by the National Bank of the credit assessments of eligible ECAIs to six steps in a credit quality assessment scale.

3. Exposures to the National Bank or the Georgian government denominated in local currency and funded in local currency shall be assigned a 0% risk weight.

Article 33. Exposures to Regional Governments or Local Authorities

1. Without prejudice to paragraph 2, exposures to regional governments and local authorities shall be risk weighted according to Table 2 of Annex 1 of this regulation in accordance with the assignment by the National Bank of the credit assessments of eligible ECAIs to six steps in a credit quality assessment scale. Unrated exposures to regional governments and local authorities shall be risk weighted at 100%.

2. Exposures to regional governments and local authorities shall be treated as exposures to the central government if there is no difference in risk between such exposures because of the specific revenue-raising powers of the former, and the existence of specific institutional arrangements the effect of which is to reduce their risk of default. The National Bank shall draw up and make public the list of the regional governments and local authorities to be risk weighted like central governments.

3. Upon the permission of the National Bank, commercial banks may risk weight all exposures to regional governments or local authorities at 100%.

Article 34. Exposures to Public Sector Entities

1. Without prejudice to paragraph 3, exposures to public sector entities shall be assigned at 100% risk weight as long as the exposures are not classified under the class of “exposures to regional governments or local authorities”.
2. In exceptional circumstances, exposures to public-sector entities may be treated as exposures to the central government in whose jurisdiction they are established where in the opinion of the National Bank there is no difference in risk between such exposures because of the existence of an appropriate guarantee by the central government. the National Bank shall draw up and make public the list of public sector entities to be risk weighted like central governments.
3. Upon the permission of the National Bank, commercial banks may risk weight all exposures to public sector entities at 100%.

Article 35. Exposures to Multilateral Development Banks

1. For the purposes of Chapter IV of this regulation, the Inter-American Investment Corporation, the Black Sea Trade and Development Bank and the Central American Bank for Economic Integration, the European Bank for Reconstruction and Development, the International Finance Corporation, the Inter-American Development Bank, the Asian Development Bank, the African Development Bank, the Council of Europe Development Bank, the Nordic Investment Bank, the Caribbean Development Bank, the International Bank for Reconstruction and Development, the European Investment Bank, the European Investment Fund, the Multilateral Investment Guarantee Agency, the International Finance Facility for Immunisation and the Islamic Development Bank are considered to be Multilateral Development Banks (MDB).
2. Without prejudice to paragraph 3, exposures to multilateral development banks shall be treated in the same manner as exposures to commercial banks in accordance with Article 37 of this regulation
3. Exposures to the following multilateral development banks shall 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;
 - 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 Immunization; and
 - n) The Islamic Development Bank.
4. Upon the permission of the National Bank commercial banks may risk weight all exposures to multilateral development banks at 100%.

Article 36. Exposures to International Organizations/Institutions

1. Exposures to the following international organizations shall be assigned a 0% risk weight:
 - a) The European Central Bank;
 - b) The International Monetary Fund;
 - c) The Bank for International Settlements.
2. Upon the permission of the National Bank, commercial banks may risk weight all exposures to international organizations/institutions at 100%.

Article 37. Exposures to Commercial Banks

1. Exposures to commercial banks with an original effective maturity of more than three months for which a credit assessment by a nominated ECAI is available shall be assigned a risk weight according to Table 3 of Annex I of this regulation in accordance with the assignment by the competent authorities of the credit assessments of eligible ECAIs to six steps in a credit quality assessment scale, defined by the National Bank.
2. Exposures to unrated institutions shall be assigned a risk weight of 50%. No claim on an unrated bank may receive a risk weight lower than that applied to claims in the jurisdiction of incorporation of the concerned bank. *(15.08.2017 N120/04)*
3. Short-term exposures to commercial bank for which a credit assessment by a nominated ECAI is available shall be assigned a risk weight according to Table 3 of Annex I of this regulation in accordance with the assignment by the competent authorities of the credit assessments of eligible ECAIs to six steps in a credit quality assessment scale.
4. Exposures to unrated institutions having the remaining effective maturity of three months or less shall be assigned a 20% risk weight. No claim on an unrated bank may receive a risk weight lower than that applied to claims in the jurisdiction of incorporation of the concerned bank. *(15.08.2017 N120/04)*
5. Exposures to commercial banks with the remaining effective maturity of three months or less which are denominated in local currency and funded in local currency shall be assigned a 20% risk weight. *(15.08.2017 N120/04)*
6. For the purpose of this article, if exposures to institutions with the remaining effective maturity of three month or less are expected to be rolled over i.e. where the effective maturity is longer than three months, they should not be classified as exposures with the remaining effective maturity of three months or less. *(15.08.2017 N120/04)*
7. Upon the permission of the National Bank, commercial banks may risk weight all exposures to commercial banks at 100%.

Article 38. Exposures to Corporates

1. Exposures for which a credit assessment by a nominated ECAI is available shall be assigned a risk weight according to Table 4 of Annex I of this regulation in accordance with the assignment by the National Bank of the credit assessments of eligible ECAIs to six steps in a credit quality assessment scale.
2. Exposures for which a credit assessment by a nominated ECAI is not available shall be assigned a 100% risk weight or the risk weight of its central government, whichever is the higher.

3. Upon the permission of the national Bank, commercial banks may risk weight all corporate claims at 100% without regard to external ratings.

Article 39. Retail Exposures

1. Exposures that comply with the criteria listed in Article 11 paragraph 2 of this regulation shall be assigned a risk weight of 75%.

Article 40. Exposures Secured by Mortgages on Residential Property

1. Exposures or any part of an exposure fully and completely secured, to the satisfaction of the National Bank, by mortgages on residential property which is or shall be occupied or let by the owner, shall be assigned a risk weight of 35%.

2. Exposures to a tenant under a property leasing transaction concerning residential property under which the commercial bank is the lessor and the tenant has an option to purchase, shall be assigned a risk weight of 35% provided that the National Bank is satisfied that the exposure of the commercial bank is fully and completely secured by its ownership of the property.

3. In the exercise of their judgment for the purposes of paragraphs 1 to 2 of this Article, the National Bank shall be satisfied only if the following conditions are met:

- a) The value of the property does not materially depend upon the credit quality of the obligor. This requirement does not preclude situations where purely macroeconomic factors affect both the value of the property and the performance of the borrower;
- b) The risk of the borrower does not materially depend upon the performance of the underlying property or project, but rather on the underlying capacity of the borrower to repay the debt from other sources. As such, repayment of the facility does not materially depend on any cash flow generated by the underlying property serving as collateral;
- c) The minimum requirements set out in paragraph 5 of the mentioned Article and the valuation rules set out in paragraph 6 are met.

4. In order for exposures to be classified as exposures secured by mortgages on residential property the exposure value to the value of protected exposure should be no higher than 80%. Accordingly, the loan or the part of the loan should be included in this class if the loan is 80% of the value of the property. (19.12.2019. N243/04)

5. For the recognition of mortgages on residential property the following minimum requirements shall be met:

- a) Legal certainty: The mortgage agreement shall be enforceable in all jurisdictions which are relevant at the time of the conclusion of the credit agreement, and the mortgage shall be properly filed on a timely basis. The arrangements shall reflect a perfected lien (i.e. all legal requirements for establishing the pledge shall have been fulfilled). The protection agreement and the legal process underpinning it shall enable the commercial bank to realize the value of the protection within a reasonable timeframe;
- b) Monitoring of property values: The value of the property shall be monitored on a frequent basis and at a minimum once every year. More frequent monitoring shall be carried out where the market is subject to significant changes in conditions. Statistical methods may be used to monitor the value of the property and to identify property that needs revaluation. The property valuation shall be reviewed by an independent valuer

when information indicates that the value of the property may have declined materially relative to general market prices. For loans exceeding GEL 200,000 or 5% of the own funds of the commercial bank, the property valuation shall be reviewed by an independent value at least every three years. 'Independent valuer' shall mean a person who possesses the necessary qualifications, ability and experience to execute evaluation and who is independent from the credit decision process;

- c) Documentation: The types of residential real estate accepted by the commercial bank and its lending policies in this regard shall be clearly documented;
 - d) Insurance: The property taken as protection must be insured.
6. The residential property valuation process must meet the following requirements:
- a) Before disbursement of the loan the property shall be valued by an independent valuer at or less than the market value;
 - b) 'Market value' means 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. The market value shall be documented in a transparent and clear manner;
 - c) The value of the collateral is equal to the market value of property. Where necessary, it should reflect the results of the monitoring required under this article and impacts caused by the existence of other requirements.
7. For the purpose of this article, only the highly liquid residential property shall be considered as a collateral. Commercial banks shall develop policy of classification of exposures as assets secured by mortgages on residential property that adequately provides for the liquidity of residential property. The methods of a commercial bank related to the liquidity criteria shall be adequately represented in the application for the National Bank approval of using the class of exposures secured by the residential property. (13.08.2018. N187/04)
8. Residential real property area must match the registered area. The policy of classification assets as secured by mortgages on residential property must determine permissible limit of errors.

Article 41. Past Due Items

1. Without prejudice to the provisions contained in paragraphs 2 and 3 of this Article, the unsecured part of any exposure (in accordance with Chapter V) that is past due for more than 90 days shall be assigned a risk weight of:
- a) 150% risk weight when specific provisions (calculation based on Regulation on Classification of assets and the loss provisioning by Commercial Banks approved by the Order of the President of the National Bank) are less than 20% of the outstanding amount of the loan (without deduction of loan loss reserves);
 - b) 100% risk weight when specific provisions (calculation based on Regulation on Classification of assets and the loss provisioning by Commercial Banks approved by the Order of the President of the National Bank) are no less than 20% of the outstanding amount of the loan (without deduction of loan loss reserves).
2. For the purpose of defining the secured part of the past due item, eligible collateral and guarantees shall be those eligible for credit risk mitigation purposes.

3. Claims or contingent claims secured by mortgages on residential property indicated in Article 40 of this regulation shall be assigned a risk weight of 100% if they are past due for more than 90 days. In addition, if specific provisions (calculation based on Regulation on Classification of assets and the loss provisioning by Commercial Banks approved by the Order of the President of the National Bank) are no less than 20% of their outstanding amount, the risk should be assigned a risk weight of 50%.
4. If a client's risk exposure is past due for more than 90 days, exposures of all other risks of that client shall also be classified as past due and shall be weighted according to paragraph one of this Article. *(15.08.2017 N120/04)*

Article 42. Items Belonging to Regulatory High-risk Categories

1. Exposures associated with particularly high risks such as investments in venture capital firm, private equity investments, which constitute less than 10% of the share capital of the entity invested in, or other high risk exposures as determined by the National Bank, shall be assigned a risk weight of 150%.
2. The National Bank may permit commercial banks non past due items to be assigned a 100% risk weight if specific provisions (without deduction of loan loss reserves) are no less than 20% of the whole exposure.
3. Property having for the purpose of renting shall be assigned a 250% risk weight.
4. In case of violation of failure to identify coefficients defined by subparagraph "a" of paragraph 5 of Article 5 of the Regulation on Assets Classification and the Creation and Use of Reserves for Losses by Commercial Banks approved by Order N117/04 dated 10 August 2017 of the President of the National Bank of Georgia: *(15.08.2017 N120/04)*
 - (a) Total exposure of risk a borrower and a co-borrower that has not been secured with real estate, as well as the portion of the secured loans that exceed the market value of the real estate used as the collateral, shall be assigned a risk weight of 150%;
 - (b) The portion of the total risk exposure of a borrower and a co-borrowed that is secured with a real estate and is not weighted according to the class of risk exposure secured with residential real estate defined Article 40 of this regulation, shall be assigned a risk weight of 100%. For the purposes of this paragraph, the market value of the real estate shall be reduced with the portion of risk exposure that is weighted according to the class of risk exposure secured with residential real estate defined Article 40 of this regulation;
 - (c) Risk positions of a borrower and a co-borrower unsecured with a real property as well as the portion of the secured loans that exceed the market value of the real estate used as the collateral, shall be assigned a risk weight of 100%, if the concerned borrower and co-borrower have risk exposures secured with real estate and the loan to value ratio has been deviated and debt service coverage ratio has been observed as per the Regulation on Assets Classification and the Creation and Use of Reserves for Losses by Commercial Banks approved by Order N117/04 dated 10 August 2017 of the President of the National Bank of Georgia.
5. In case of deviation from loan to value ratio for loans secured by precious metals and stones and classified as standard as per paragraph 6 of Article 5 of the Regulation on Assets Classification and the Creation and Use of Reserves for Losses by Commercial Banks approved by Order N117/04 dated 10 August 2017 of the President of the National Bank of Georgia, total risk exposure of a borrower and a co-borrower where the loan is secured only by precious metals

and stones and no capacity analysis has been carried out, shall be assigned a risk weight of 150%. The portion of risk exposure secured with gold, the risk of which is weight at 0%, shall not be included in this case. (15.08.2017 N120/04)

Article 43. Short-term Exposures to Corporates (15.08.2017 N120/04)

1. Exposures to corporates with the remaining effective maturity of more than three for which a credit assessment by a nominated ECAI is available shall be assigned a risk weight according to Table 5 in Annex I, in accordance with the mapping by the National Bank of the credit assessments of eligible ECAIs to six steps in a credit quality assessment scale.
2. For the purpose of the represented Article, if exposures to institutions with the remaining effective maturity of three month or less are expected to be rolled over i.e. where the effective/forecasted maturity is longer than three months.

Article 44. Exposures in the Form of Collective Investment Undertakings (CIUs)

1. Without prejudice to paragraph 3 of this Article, exposures in collective investment undertakings (CIUs) shall be assigned a risk weight of 100%.
2. Exposures in the form of CIUs for which a credit assessment by a nominated ECAI is available shall be assigned a risk weight according to Table 6 of Annex I, in accordance with the assignment by the National Bank of the credit assessments of eligible ECAIs to six steps in a credit quality assessment scale.
3. Where the National Bank considers that a position in a CIU is associated with particularly high risks they shall require that that position is assigned a risk weight of 150%.

Article 45. Other Items

1. Property, plant and equipment shall be assigned a risk weight of 100%.
2. Cash in hand and equivalent cash items shall be assigned a 0% risk weight. Cash items (in the process of collection) shall be assigned a 20% risk weight
3. The amount of significant investments in unconsolidated commercial banks, insurance entities and other financial institutions, more than 10% share capital of which are held by a commercial bank, and DTA, that are not deducted in the calculation of Common Equity Tier 1, will be risk weighted at 250%. (15.08.2017 N120/04)
4. Investments in unconsolidated commercial banks, insurance entities and other financial institutions which are less than 10% of the share capital of the unconsolidated institution invested in, and that are not deducted in the calculation of Common Equity Tier 1, will be risk weighted at 100%.
5. Holdings of equity and/or other participations constituting less than 10% of the capital of other legal entities except where deducted from the regulatory capital, shall be assigned a risk weight of 100%. (15.08.2017 N120/04)
6. Gold bullion of commercial bank held in own vaults or on an allocated basis to the extent backed by bullion liabilities shall be assigned a 0% risk weight.
7. In the case of asset sale and repurchase agreements and outright forward purchases, the risk weight shall be that assigned to the assets in question and not to the counterparties to the transactions.

8. All other assets not classified in one of the other exposure classes as defined in Article 11, shall be assigned a 100% risk weight.

Article 46. Use of ECAIs' credit assessments for the determination of risk weights

1. A commercial bank may nominate one or more eligible ECAIs to be used for the determination of risk weights to be assigned to asset and off-balance sheet items.
2. A commercial bank which decides to use the credit assessments produced by an eligible ECAI for a certain class of items must use those credit assessments consistently for all exposures belonging to that class.
3. A commercial bank which decides to use the credit assessments produced by an eligible ECAI must use them in a continuous and consistent way over time.
4. A commercial bank can only use ECAIs credit assessments that take into account all amounts both in principal and in interest owed to it.
5. If only one credit assessment is available from a nominated ECAI for a rated item, that credit assessment shall be used to determine the risk weight for that item.
6. If two credit assessments are available from nominated ECAIs and the two correspond to different risk weights for a rated item, the higher risk weight shall be assigned.
7. If more than two credit assessments are available from nominated ECAIs for a rated item, the two assessments generating the two lowest risk weights shall be referred to. If the two lowest risk weights are different, the higher risk weight shall be assigned. If the two lowest risk weights are the same, that risk weight shall be assigned.

Article 47. Issuer and Issue Credit Assessment

1. Where a credit assessment exists for a specific issuing program or facility to which the item constituting the exposure belongs, this credit assessment shall 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 program 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 shall be used by the commercial bank if it produces a higher risk weight than would otherwise be the case or if it produces a lower risk weight and the exposure in question ranks *pari passu* or senior in all respects to the specific issuing program or facility or to senior unsecured exposures of that issuer, as relevant.
3. Credit assessments for issuers within a corporate group cannot be used as credit assessment of another issuer within the same corporate group.

Article 48. Long-term and Short-term Credit Assessment

1. Short-term credit assessments may only be used for short-term asset and off-balance sheet items constituting exposures to commercial banks and corporates.
2. Any short-term credit assessment shall only apply to the item the short-term credit assessment refers to, and it shall not be used to derive risk weights for any other item.

3. 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 shall also be assigned a 150% risk weight.
4. If a short-term rated facility is assigned a 50% risk-weight, no unrated short-term exposure shall be assigned a risk weight lower than 100%.

Article 49. Local and Foreign Currency Assessments

1. 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.

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Chapter XVI. Counterparty Credit Risk

Article 50. Counterparty Credit Risk

1. 'Counterparty Credit Risk (CCR)' means the risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flows.
2. For the purpose of this Article only the counterparty credit risk involved in interest rate and foreign-exchange rate derivatives (i.e. futures, forwards, swaps, options, and other off-balance sheet liabilities originating from other similar contracts), are taken into account.
3. If the term of the interest rate or the foreign-exchange rate derivative contract does not exceed 14 calendar days, it shall not be considered for risk-weighting purposes.
4. In order to calculate the exposure value for interest rate and foreign-exchange rate derivative contract, the following credit conversion factors shall apply in accordance with Table 7 of Annex I of this regulation.

Chapter XVII. Credit Risk Mitigation

Article 51. Eligibility

1. This Chapter sets out eligible forms of credit risk mitigation for the purposes of Article 16 of this regulation;

Article 52. Eligibility. Funded Credit Protection

1. The on-balance sheet netting of mutual claims between the commercial bank and its counterparty may be recognized as eligible.
2. Eligibility is limited to reciprocal cash balances between the commercial bank and the counterparty.
3. Only loans and deposits of the lending commercial bank may be subject to a modification of risk-weighted exposure amounts

4. The following items may be recognized as eligible Collateral:
 - a) The following types of financial items:
 - a.a) Cash on deposit with, or cash assimilated instruments held by, the lending commercial bank. Cash assimilated instruments are certificates of deposits and other identical instruments, issued by lending commercial bank;
 - a.b) The following group of debts securities by central governments or central banks, regional governments and local authorities, public sector entities, multilateral development banks and international organizations/institutions:
 - a.b.a) Debt securities issued by central governments or central banks, which securities have a credit assessment by an ECAI recognized as eligible for the purposes of Chapter IV of this regulation which has been determined by the National Bank 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;
 - a.b.b) Debt securities issued by regional governments or local authorities, which are treated as exposures to the central government in whose jurisdiction they are established under Chapter IV of this regulation;
 - a.b.c) Debt securities issued by public sector entities, exposures to which are treated as exposures to central government under paragraph 2 of Articles 34 of this regulation;
 - a.b.d) Debt securities issued by multilateral development banks other than those to which a 0% risk weight is assigned under Chapter IV of this regulation;
 - a.b.e) Debt securities issued by international organizations/institutions which are assigned a 0% risk weight under Chapter IV of this regulation;
 - a.c) The second group of debts securities by regional governments and local authorities, public sector entities and multilateral development banks:
 - a.c.a) Debt securities issued by commercial banks, which securities have a credit assessment by an eligible ECAI which has been determined by the National Bank to be associated with credit quality step 3 or above under the rules for the risk weighting of exposures to commercial banks under Chapter IV of this regulation;
 - a.c.b) Debt securities issued by regional governments or local authorities, except debts securities which are treated as exposures to the central government in whose jurisdiction they are established under Chapter IV of this regulation;
 - a.c.c) Debt securities issued by multilateral development banks except debt securities to which a 0% risk weight is assigned under Chapter IV of this regulation;
 - a.d) Debt securities issued by legal entities, which securities have a credit assessment by an eligible ECAI which has been determined by the National Bank to be associated with credit quality step 3 or above under the rules for the risk weighting of exposures to corporates; under Chapter IV of this regulation;
 - a.e) Debt securities with a short-term credit assessment by an eligible ECAI which has been determined by the National Bank to be associated with credit quality step 3 or above under the rules for the risk weighting of short term exposures;
 - a.f) Equities or convertible bonds (which are not issued by lending commercial bank) that are included in a main index. For the purposes of this subparagraph, main index is the one recognized by the National Bank as such;
 - a.g) Gold (in standard or equivalent of standard bullion).

- b) Debt securities issued by commercial banks which securities do not have a credit assessment by an eligible ECAI may be recognized as eligible collateral in case/if:
 - b.a) They are listed on a recognized exchange. For the purposes of this article, recognized exchanges means exchanges which meet the following conditions and which are approved by the National Bank as such ones: they function regularly and they have rules, issued or approved by the appropriate authorities of the home country of the exchange, defining the conditions for the operation and of access to it, as well as the conditions that shall be satisfied by a contract before it can effectively be dealt on the exchange;
 - b.b) They qualify as senior debt;
 - b.c) All other rated issues by the issuing commercial bank of the same seniority have a credit assessment by an eligible ECAI which has been determined by the National Bank to be associated with credit quality step 3 or above under the rules for the risk weighting of exposures to commercial banks or short term exposures under Chapter IV of this Article;
 - b.d) The lending commercial bank has no information to suggest that the issue would justify a credit assessment below that indicated in paragraph 4, subparagraph “b.c” above;
 - b.e) The commercial bank can demonstrate to the National Bank that the market liquidity of the instrument is sufficient for these purposes.
 - c) Units in collective investment undertakings may be recognized as eligible collateral if the following conditions are satisfied:
 - c.a) They have a daily public price quote; and
 - c.b) The collective investment undertaking is limited to investing in instruments that are eligible for recognition under subparagraphs “a” and “b” of paragraph 4.
 - d) The use (or potential use) by a collective investment undertaking of derivative instruments to hedge permitted investments shall not prevent units in that undertaking from being eligible;
 - e) For the purposes of subparagraphs “a” of paragraph 4, where a security has two credit assessments by eligible ECAIs, the less favorable assessment shall be deemed to apply. In cases where a security has more than two credit assessments by eligible ECAIs, the two most favorable assessments shall be deemed to apply. If the two most favorable credit assessments are different, the less favorable of the two shall be deemed to apply.
5. Other funded credit protection:
- a) Cash on deposit with, or cash assimilated instruments held by a third party commercial bank in a non-custodial arrangement and pledged to the lending commercial bank may be recognized as eligible credit protection.

Article 53. Eligibility. Unfunded Credit Protection

1. The following parties may be recognized 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 organizations/institutions exposures to which are assigned 0% risk weight under Chapter IV of this regulation;
 - e) Public sector entities, claims on which are treated by the NBG as claims on commercial banks or central governments under Chapter IV of this regulation;

- f) Commercial banks; and
- g) Other corporate entities, including parent, subsidiary and affiliate corporate entities of the commercial bank, that have a credit assessment by a recognized ECAI which has been determined by the National Bank to be associated with credit quality step 2 or above under the rules for the risk weighting of exposures to corporates under Chapter IV of this regulation;

Article 54. Minimum Requirements

1. The commercial bank must satisfy the National Bank that it has adequate risk management processes to control those risks to which the commercial bank may be exposed as a result of carrying out credit risk mitigation practices.
2. Notwithstanding the presence of credit risk mitigation taken into account for the purposes of calculating risk-weighted exposure amounts and as relevant expected loss amounts, commercial banks shall continue to undertake full credit risk assessment of the underlying exposure and be in a position to demonstrate the fulfillment of this requirement to the National Bank.

Article 55. Minimum Requirements. Funded Credit Protection

1. For on-balance sheet netting agreements to be recognized for the purposes of Articles 15 to 17, the following conditions shall be satisfied:
 - a) They must be legally effective and enforceable in all relevant jurisdictions, including in the event of the insolvency or bankruptcy of a counterparty;
 - b) The commercial bank must be able to determine at any time those assets and liabilities that are subject to the on-balance sheet netting agreement;
 - c) The commercial bank must monitor and control the risks associated with the termination of the credit protection; and
 - d) The commercial bank must monitor and control the relevant exposures on a net basis.
2. For the recognition of financial collateral and gold, the following conditions shall be met:
 - a) Low correlation: the credit quality of the obligor and the value of the collateral must not have a material positive correlation. Securities issued by the obligor, or any related group entity, are not eligible;
 - b) Legal certainty: commercial banks shall fulfill 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. Commercial banks shall have conducted sufficient legal review confirming the enforceability of the collateral arrangements in all relevant jurisdictions. They shall re-conduct such review as necessary to ensure continuing enforceability.
 - c) Operational requirements: the collateral arrangements shall be properly documented, with a clear and robust procedure for the timely liquidation of collateral. Commercial banks shall employ 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 commercial bank's overall risk profile. The commercial bank shall have documented policies and practices concerning the types and amounts of collateral accepted. Commercial banks shall calculate the market value of

the collateral, and revalue it accordingly, with a minimum frequency of once every six months and whenever the commercial bank has reason to believe that there has occurred a significant decrease in its market value. Where the collateral is held by a third party, commercial banks must take reasonable steps to ensure that the third party segregates the collateral from its own assets.

d) In order for the equivalent of the gold bullion to be recognized for credit risk mitigation purposes besides meeting the requirements set out in paragraph 2 **Error! Reference source not found.** subparagraph “a”, commercial banks also need to develop an adequate assessment of the value of equivalent of the gold bullion and discounting policies and procedures. Such policies and procedures must satisfy NBG in order for the equivalent of the gold bullion to be recognized for credit risk mitigation purposes.

e) In addition to the requirements set out in paragraph 2 for the recognition of financial collateral the residual maturity of the protection must be at least as long as the residual maturity of the exposure.

3. Minimum requirements for the recognition of other funded credit protection:

- a) To be eligible for the treatment set out at Article 58, paragraph 2, the protection referred to in Article 52, paragraph 3 of this regulation must satisfy the following conditions:
 - a) The borrower's claim against the third party commercial bank is openly pledged or assigned to the lending commercial bank and such pledge or assignment is legally effective and enforceable in all relevant jurisdictions;
 - b) The third party commercial bank is notified of the pledge or assignment;
 - c) As a result of the notification, the third party commercial bank is able to make payments solely to the lending commercial bank or to other parties with the lending commercial bank's consent; and
 - d) The pledge or assignment is unconditional and irrevocable.

Article 56. Minimum Requirements. Unfunded Credit Protection

1. Requirements common to guarantees:

- a) For the credit protection deriving from a guarantee to be recognized the following conditions shall be met:
 - a.a) The credit protection shall be direct;
 - a.b) The extent of the credit protection shall be clearly defined and incontrovertible;
 - a.c) The credit protection contract shall not contain any clause, the fulfillment of which is outside the direct control of the lender, that:
 - a.c.a) Would allow the protection provider unilaterally to cancel the protection;
 - a.c.b) would increase the effective cost of protection as a result of deteriorating credit quality of the protected exposure;
 - a.c.c) 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;
 - a.c.d) Could allow the maturity of the credit protection to be reduced by the protection provider; and
 - a.d) It must be legally effective and enforceable in all jurisdictions which are relevant at the time of the conclusion of the credit agreement.

- b) The commercial bank shall satisfy the National Bank that it has systems in place to manage potential concentration of risk arising from the commercial bank's use of guarantees. The commercial bank must be able to demonstrate how its strategy in respect of its use of guarantees interacts with its management of its overall risk profile.
 - c) For a guarantee to be recognized the following conditions shall also be met:
 - c.a) On the qualifying default of and/or non-payment by the counterparty, the lending commercial bank shall have 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. Payment by the guarantor shall not be subject to the lending commercial bank first having to pursue the obligor.
 - c.b) The guarantee shall be an explicitly documented obligation assumed by the guarantor; and
 - c.c) The guarantee shall cover all types of payments the obligor is expected to make in respect of the claim. Where certain types of payment are excluded from the guarantee, the recognized value of the guarantee shall be adjusted to reflect the limited coverage.
2. Sovereign and other public sector counter-guarantees:
- a) Where an exposure is protected by a guarantee which is counter-guaranteed by a central government or central bank, a regional government or local authority, a public sector entity, claims on which are treated as claims on the central government in whose jurisdiction they are established under Chapter IV of this regulation, a multilateral development bank to which a 0% risk weight is assigned under or by virtue of Chapter IV of this regulation, the exposure may be treated as protected by a guarantee provided by the entity in question, provided the following conditions are satisfied:
 - a.a) The counter-guarantee covers all credit risk elements of the claim;
 - a.b) Both the original guarantee and the counter-guarantee meet the requirements for guarantees set out in Article 56, paragraphs 1, except “a” subparagraph of the abovementioned paragraph
 - a.c) The National Bank is satisfied that the cover is robust and that 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.
 - b) The treatment set out in paragraph 2, subparagraph “a” also applies to an exposure which is not counter-guaranteed by an entity listed in that paragraph if that exposure's counter-guarantee is in turn directly guaranteed by one of the listed entities and the conditions listed in that paragraph are satisfied.

Article 57. Calculation of the Effects of Credit Risk Mitigation

1. Where the provisions in Articles 51 to 56 are satisfied, the calculation of risk-weighted exposure amounts under Chapter IV of this regulation may be modified in accordance with the provisions under Articles 57, 58 and 59 of this regulation;
2. Where commercial banks have legally enforceable netting arrangements for loans and deposits they may calculate capital requirements on the basis of net credit exposures subject to the conditions in Article 56 of this regulation;
3. To calculate the effect of credit risk mitigation by using financial collateral, commercial banks may use the simple approach, defined by the Article 58, paragraph 1 of this regulation. This approach substitutes the risk weighting of the collateral for the risk weighting of the counterparty

for the collateralized portion of the exposure (generally subject to a 20% floor). Partial collateralization is recognized. Mismatches in the maturity of the underlying exposure and the collateral are not allowed.

4. Where the credit protection is provided by unfunded credit protection, the protected portion is assigned the risk weight of the protection provider. The uncovered portion of the exposure is assigned the risk weight of the underlying counterparty. Where the credit protection is denominated in a currency different from that in which the exposure is denominated — i.e. there is a currency mismatch — the amount of the exposure deemed to be protected will be reduced by the application of a haircut.

Article 58. Calculation of the Effects of Credit Risk Mitigation. Funded Credit Protection

1. Financial Collateral Simple Method:

- a) The Financial Collateral Simple Method shall be available only where risk-weighted exposure amounts are calculated under Chapter IV of this regulation;
- b) Under this method, recognized financial collateral is assigned to a value equal to its market value as determined in accordance with Article 55, paragraph 2 subparagraph “a” of this regulation;
- c) The risk weight that would be assigned under Chapter IV of this regulation if the lender had a direct exposure to the collateral instrument shall be assigned to those portions of risk exposures collateralized by the market value of recognized collateral, with a minimum of 20% except as specified in subparagraph “d” of this paragraph. The remainder of the exposure shall receive the risk weight according to the exposure class to which it would be assigned under Chapter IV of this regulation. For the purpose of calculating the mitigation effect for off-balance sheet elements, 100% shall be taken as the credit-conversion factor to calculate off-balance sheet risk exposure value, instead of the value determined by paragraph one of Article 10 of this regulation; (15.08.2018 N120/04)
- d) A 0% risk weight may be assigned if:
 - d.a) The exposure and the collateral are denominated in the same currency, and
 - d.b) The collateral is cash on deposit or a cash assimilated instrument; or
 - d.c) Market value of the collateral has been discounted by 20% and includes:
 - d.c.a) Debt securities issued by central governments or central banks exposures to which a 0% risk weight is assigned under Chapter IV of this regulation;
 - d.c.b) 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 Chapter IV of this regulation;
 - d.c.c) Debt securities issued by multilateral development banks to which a 0% risk weight is assigned under Chapter IV of this regulation;
 - d.c.d) Debt securities issued by international organizations which are assigned a 0% risk weight under Chapter IV of this regulation;

2. Other funded credit protection:

- a) Where the conditions set out in Article 55, paragraph 3 are satisfied, credit protection falling within the terms of Article 52, paragraph 3 of this regulation may be treated as a guarantee by the third party commercial bank.

3. Exposures secured by the equivalent of standard gold bullion shall be reduced by 50% of the market price of collateral.

Article 59. Calculation of the Effect of Credit Risk Mitigation. Unfunded Credit Protection

1. Valuation (10.03.2015 N27/04)

a) The value of unfunded credit protection (G) shall 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.

a.a) Where unfunded credit protection is a credit derivative not extending to credit restructuring, the value of the credit protection calculated under the subparagraph “a” above shall be reduced by 40%; or

a.b) Where unfunded credit protection is a credit derivative not extending to credit restructuring, the value of the credit protection shall be no higher than 60% of the exposure value.

b) Where unfunded credit protection is denominated in a currency different from that in which the exposure is denominated (a currency mismatch) the value of the credit protection shall be reduced as follows:

$$G^* = G \times (1 - HFX)$$

Where:

b.a) G is the nominal amount of the credit protection,

b.b) G* is G adjusted for any foreign exchange risk, and

b.c) Hfx is the volatility adjustment for any currency mismatch between the credit protection and the underlying obligation.

b.d) Where there is no currency mismatch

$$G^* = G$$

c) The volatility adjustments for any currency mismatch shall be 8%.

2. Calculating risk-weighted exposure amounts:

a) Full protection: g shall be the risk weight to be assigned to an exposure which is fully protected by unfunded protection (GA), where g is the risk weight of exposures to the protection provider as specified under Chapter IV of this regulation;; and GA is the value of G* as calculated under paragraph 1 of this Article.

b) Partial protection — equal seniority: Where the protected amount is less than the exposure value and the protected and unprotected parts are of equal seniority — i.e. the commercial bank and the protection provider share losses on a pro-rata basis, proportional Regulatory Capital relief shall be afforded.

For the purposes of Article 12, risk-weighted exposure amounts shall be calculated in accordance with the following formula:

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

where:

b.a) E is the exposure value;

b.b) GA is the value of G* as calculated under paragraph 1 subparagraph “c”;

b.c) r - is the risk weight of exposures to the obligor as specified under Chapter IV; and

b.d) g is the risk weight of exposures to the protection provider as specified under Chapter IV.

- c) Sovereign guarantees: the National Bank extends the treatment provided for in Article 32, paragraphs 3 of this regulation 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.

Chapter XVIII. Operational Risk

Article 60. Calculating Capital Requirements for Operational risk using Basic Indicator Approach

1. In accordance with the basic indicator approach, the operational risk capital requirement shall comprise 15% of the relevant indicator as determined by the National Bank and which is defined in paragraph 2, subparagraph “a” to “h” of the Article below.
2. Definition of the relevant indicator:
 - a) The National Bank defines the relevant indicator for capital calculation purposes;
 - b) The relevant indicator, as defined by The National Bank shall comprise the average of over the last three years of the sum of net interest income and net non-interest income consisting out of the elements as defined in subparagraph “e” of this paragraph;
 - c) The three-year average is calculated as a result of the last three 12-month observations at the end of the financial year. When audited results are not available, business estimates may be used;
 - d) If, for any indicator, the sum of net interest and net non-interest income is negative or is equal to zero, the abovementioned result will not be included in the calculation of the three-year average. Accordingly, only the outcome, which consists of the sum of positive indicators divided by the number of years for which the indicator was positive, shall be used in the calculation of operational risk capital;
 - e) The relevant indicator, as determined by, the National Bank shall consist of the sum of the elements listed in Table 8 of Annex I. Each element must be included in the calculation of the sum irrelevant of the sign of the element, whether it is negative or positive;
 - f) The relevant indicator as defined by the National Bank (see Annex I, table 8), is calculated before any deductions arising from operational expenses or provisioning. Operational expenses shall include expenses associated with the outsourcing of services that are linked to third parties. A third party shall include any legal entity that is not the parent or subsidiary company of the commercial bank or is not the subsidiary of the parent company of which the commercial bank is a subsidiary itself;
 - g) The following elements must not be included in the calculation of the relevant indicator as determined by the National Bank
 - g.a) Income/loss arising from the sale of non-trading book items;
 - g.b) Income from extraordinary or irregular operations;

- g.c) Income from insurance.
- h) When revaluation of trading book items is included in the profit/loss statement, the revaluation must be included in the calculation of the indicator.

Article 61. Calculating Capital Requirements for Operational risk using Standardized Approach

1. Capital Requirements

- a) The operational risk capital requirement using the standardized approach shall be calculated as the average over the last three years of the annual relevant indicators (relevant indicator as determined in Article 60, paragraph 2, subparagraphs “a” to “h” of this regulation) calculated each year across the business lines referred to in table 9 of Annex I and multiplied with the relevant capital requirement given in table 9. In addition, it is important to take into consideration that a negative capital result that may occur from the relevant indicator in any of the business lines may be imputed to the whole, but when, for the whole year the calculated capital amount from all business lines is negative, then the indicator for that year shall be zero;
 - b) The three-year average is calculated as the last three 12-month observations at the end of the financial year. When audited data are not available, business estimates for the data may be used.
2. The commercial banks must develop and implement documented specific policies and create criteria for mapping activities into the various business lines for the relevant indicator and describe which business line would include a particular activity for the standardized approach. The principles for business line mapping are listed below:
- a) All activities of a commercial bank must be mapped to a specific business line in a mutually exclusive and a jointly exhaustive manner;
 - b) An activity which is not easily mapped within the business line framework, but represents an ancillary function to the activity that has already been mapped within the business line framework, must be allocated to the business line which it supports. If the given activity supports more than one business line with its ancillary function, an objective mapping-allocation criteria must be used;
 - c) If a given activity cannot be readily allocated to any business line, in this case the given activity must be mapped to a business line yielding the highest percentage/charge. The same must be done for ancillary activities;
 - d) For the purposes of operational risk capital calculation, the mapping of activities must be in line with credit and market risk categories;
 - e) The senior management of a commercial bank is responsible for the correct allocation and mapping policy of the bank’s activities into the various business lines;
 - f) The mapping process must be subject to independent review.

3. In order for the commercial bank to use the standardized approach for the calculation of operational risk capital, besides adhering to the general risk management standards, the bank shall meet the criteria that are listed below. The successful implementation of the abovementioned criteria shall depend on the size of the commercial bank and the complexity of its operations and shall take into consideration the principle of proportionality.

- a) Commercial banks shall have a well-documented assessment and management system for operational risk which includes a clear set of responsibilities within the frames of the system. The abovementioned systems shall incorporate and identify the exposure to operational risk of a commercial bank and monitor operational risk events, including material losses. The given system must be subject to regular independent review;
- b) The operational risk assessment system must be closely integrated into the overall risk management process of a commercial bank. The outcome of the assessment system shall be an integral part of monitoring a commercial bank's risk profile and the control process;
- c) The commercial banks are required to implement an operational risk reporting system which includes among others, reporting to the management. The commercial bank must have procedures in place that outline the action plan and the steps to be taken in terms of the information included in the operational risk management reports.

Chapter XIX. Transitional Provisions

Article 62. Transitional Provisions

1. All commercial banks need to implement the minimum capital adequacy requirements as laid down in this regulation at the latest 2014 June 30 and comply permanently after the given date.
2. The commercial banks need to apply and receive regulatory approval from the National Bank for the use of:
 - a) A risk weight of 75% for retail claims and contingent retail claims;
 - b) A risk weight of 35% for claims or contingent claims secured by mortgages on residential property;
 - c) Ratings provided by ECAI;
 - d) The Standardized Approach for Operational Risk; and
 - e) Credit Risk Mitigation.
3. The National Bank will consider the approval based on documentation to be provided by the commercial bank, which should explain and document clearly the policies and the measures taken by the bank to assure the compliance with the relevant requirements as set out in this regulation. The application should be received at least two months before the date the commercial banks wishes to start using this approaches mentioned in this paragraph.
4. Until December 31, 2014 upon the permission of the National Bank, commercial banks are allowed not to assign exposures to classes defined under Chapter XV Articles 32, 33, 34, 35, 36,

37, 38, 43 and 45 paragraphs 1, 2 and 6 of this regulation. Commercial banks may put them into other assets category under Article 45, paragraph 8. of this regulation

5. Until December 31, 2014 upon the permission of the National Bank, commercial banks are not allowed to assign off-balance sheet items to off-balance sheet classes defined under Article 31 of this regulation and assign every item to high risk category exposures which are assigned a 100% risk-weight.

6. Commercial banks should keep calculating and reporting in parallel with the minimum capital requirements in accordance with the “Regulation on Capital Adequacy Requirements for Commercial Banks” approved by Order #18/04 dated 12 February 2015 of the President of the National Bank of Georgia and only stop doing so by the notice of the National bank. All banks are required to present first report of the new minimum capital requirement to NBG as of December 31, 2013 and shall be presented at the latest 10th day of the next month. (10.03.2015 N27/04)

7. During the transition period (2014 – 2017 years) commercial banks need to comply both to the minimum requirements as defined by the given regulation and to the ones per “Regulation on Capital Adequacy Requirements for Commercial Banks” approved by Order #18/04 dated 12 February 2015 of the President of the National Bank of Georgia according to the following rule: the tier 1 and tier 2 capital requirements Order #18/04 dated 12 February 2015 of the President of the National Bank of Georgia must be multiplied by an adjustment factor which for the year 2014 should be 100%, for 2015 – 95%, for 2016 – 90%, for 2017 – 80%. (10.03.2015 N27/04)

8. During 2014 year or the purpose of calculation different regulatory ratios commercial banks should use regulatory capital definition calculated in accordance with “Regulation on Capital Adequacy Requirements for Commercial Banks” approved by Order #18/04 dated 12 February 2015 of the President of the National Bank of Georgia and only after that, capital as defined by this regulation. (10.03.2015 N27/04)

9. After the entrance of this regulation into force until 2017 commercial banks may include in regulatory capital instruments which do not meet the requirements of Article 30 paragraph 1 subparagraph “d” subparagraph “d.c” if prepayment is only allowed upon the permission of the National Bank and if this condition is clearly set out in the contract.

10. The commercial banks will be required to report for the first time on the outcomes of the internal Capital Adequacy Assessment Current Process as described in Article 10 of this regulation at the latest at 30 September 2014. (25.08.2014 N81/04)

11. The extension of the requirements of this regulation is only allowed upon the permission of the National Bank.

12. Requirements of subparagraph “n” of paragraph one of Article 29 and subparagraph “i” of paragraph one of Article 30 of this regulation shall not apply to instruments issued and funded by natural persons before 10 August 2017. (15.08.2017 N120/04)

13. Requirements of paragraphs 4 and 5 of Article 42 of this regulation shall not apply to the remainders of risk exposures originating from contractual relationships earlier than 30 November 2017. (15.08.2017 N120/04)

14. Commercial banks, which have the approval from the National Bank to weight exposures secured by residential property with 35% risk weight, for the purpose of paragraph 7 of article 40, shall apply the renewed application, which shall include criteria for assessment the liquidity of the residential property and monitoring processes. Before apply this application and/or receive the approval from the National Bank, commercial banks shall continue to weight risk positions with the existing approach. (13.08.2018. N187/04)

Table 1						
Exposures to central governments or central banks						
Credit quality step	1	2	3	4	5	6
Risk weight	0%	20%	50%	100%	100%	150%

Table 2						
Exposures to regional governments and local authorities						
Credit quality step	1	2	3	4	5	6
Risk weight	20%	50%	100%	100%	100%	150%

Table 3 (15.08.2018 N120/04)						
Exposures to Commercial Banks						
Credit quality step	1	2	3	4	5	6
Risk weight of exposure	20%	50%	50%	100%	100%	150%
Exposures to commercial bank with the remaining effective maturity of three months or less						
Credit quality step	1	2	3	4	5	6
Risk weight of exposure	20%	20%	20%	50%	50%	150%

Table 4						
Exposures to corporates						
Credit quality step	1	2	3	4	5	6
Risk weight	20%	50%	100%	100%	150%	150%

Table 5 (15.08.2018 N120/04)						
Exposures to corporates with the remaining effective maturity of three months or less						
Credit quality step	1	2	3	4	5	6
Risk weight	20%	50%	100%	150%	150%	150%

Table 6						
Exposures in the form of collective investment undertakings (CIUs)						
Credit quality step	1	2	3	4	5	6
Risk weight	20%	50%	100%	100%	150%	150%

Table 7		
Original maturity	Interest rate contracts	Foreign-exchange rate contracts
Less than one year	0.5%	2,0%
From one to two years	1,0%	5,0%
On every additional year	+1,0%	+3,0%

Table 8
1. Interest income and related income
2. Interest expenses and related expenses
3. Income from shares and variable/fixed-rate securities
4. Income from commissions/fees
5. Commissions/fees expenses
6. Net income/loss from financial operations
7. Other operating income

Table 9		
Business Line	Description of Activity	Capital requirement
Corporate Finance	Underwriting of financial instruments and/or placing of financial instruments on an enterprise 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 Banking	Acceptance of deposits and other repayable funds Cards services Lending Financial leasing Guarantees and commitments	12%
Commercial Banking	Acceptance of deposits and other repayable funds Lending Financial leasing Guarantees and commitments	15%
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 Other forms of asset management	12%
Retail Brokerage	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	12%

	commitment basis	
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Annex II

(25.08.2014 N81/04)

Credit Worthiness Rating 6-Tier Scale				
		Fitch	Moody's	Standard & Poor's
Credit Worthiness Rating 6-Tier Scale	1	AAA to AA-	Aaa to Aa3	AAA to AA-
	2	A+ to A-	A1 to A3	A+ to A-
	3	BBB+ to BBB-	Baa1 to Baa3	BBB+ to BBB-
	4	BB+ to BB-	Ba1 to Ba3	BB+ to BB-
	5	B+ to B-	B1 to B3	B+ to B-
	6	CCC+ and lower	Caa1 and lower	CCC+ and lower
Credit Worthiness Rating 6-Tier Scale for Short-Term Credit Assessment	1	F1+, F1	P-1	A-1+, A-1
	2	F2	P-2	A-2
	3	F3	P-3	A-3
	4	Lower than F3	NP	B-1, B-2, B-3, C
	5			
	6			