GENERAL SECRETARIAT
INTERNATIONAL AFFAIRS DEPARTMENT
INTERNATIONAL BANKING AFFAIRS DIVISION

NOTICE

METHODS FOR CALCULATING THE CAPITAL RATIO 2013

(revised version of 2013-03-26)

Questions concerning this Notice should be addressed to the International Banking Affairs Division of the ACP (sai@acp.banque-france.fr).
The Notice can be downloaded from the International section of the ACP website, under Supervisory Disclosure - Rules and Guidance

TABLE OF CONTENTS

1. Introduction

1.1. Purpose of the Notice

1 This Notice describes how the Autorité de Contrôle Prudentiel (ACP) will supervise the implementation of French capital adequacy regulations, which are based in particular on European Directives 2006/48/EC and 2006/49/EC (collectively referred to as CRD), as amended by Directives 2009/27/EC, 2009/83/EC and 2009/111/EC (collectively referred to as CRD2) and by Directive 2010/76/EU (CRD3). This Notice thus refers to the regulations currently in force in this area[1], and particularly the Order of 20 February 2007 (amended)[2].

2 This Notice is published for general information; it does not prejudge specific decisions that the ACP may be called upon to make on the basis of its examination of specific institutions. Nor does it attempt to cover every aspect of the calculation of capital; it addresses those aspects for which additional explanation was judged useful. Its contents are based on questions that were transmitted by institutions to the General Secretariat of the ACP (SGACP) or that were discussed at the European level, and are not meant to be exhaustive. The Notice is likely to evolve and expand in response to additional questions that will emerge over time as the regulations are implemented and banking and financial practices develop[3].

3 This Notice focuses on Pillar 1 of the capital adequacy framework, which deals with calculating minimum capital requirements. The implementation of Pillar 2, which covers the supervisory review process, was the subject of a separate document published at the end of 2006 (this document is available on the website of the ACP). The European Banking Authority (EBA) publishes an annual analysis of disclosures made by banks under Pillar 3, which deals with transparency and market discipline. In their Pillar 3 disclosures for the year ended 31 December 2012, and more generally in their financial communications in the period before the effective entry into force of the rules, institutions may not claim to be in compliance with the Basel III Accord[4] or with the European CRD4 /CRR regime[5] if they do not satisfy all the provisions of the Basel III Accord or CRD4/CRR respectively.

4 As of 1 January 2013, this Notice replaces the document published by the SGACP on 14 January 2012 and entitled “Methods for Calculating the Capital Ratio – 2012”.

5 This Notice can be downloaded from the International section of the ACP website, under Supervisory Disclosure – Rules and Guidance. The French version of this Notice can also be downloaded from the ACP website.

---

1 Notably the Order of 20 February 2007 relating to capital requirements for credit institutions and investment firms, Regulation 89-07 on the accounting treatment of asset disposal or securitisation transactions, Regulation 90-02 on capital, Regulation 91-05 on the capital ratio, Regulation 97-02 on the internal control of credit institutions and investment firms, Regulation 2000-03 on prudential supervision on a consolidated basis and additional supervision, and Instruction 2007-02 of the Commission Bancaire relating to capital requirements for credit institutions and investment firms.

2 Order of 20 February 2007 relating to capital requirements for credit institutions and investment firms, amended by the Orders of 19 October 2007, 11 September 2008, 29 October 2009, 25 August 2010, 13 December 2010 and 23 November 2011, as well as by Executive Order 2010-76 of 21 January 2010.

3 Amendments to the Notice introduced in the course of the year are summarized in annex H.

4 The Basel III Accord on a global regulatory framework and the Basel III Accord on liquidity risk were published on 16 December 2010. A revised version of the Basel III Accord, updated to cover counterparty risk, was published on 1 June 2011.

5 Draft European Capital Requirements Directive (CRD) and Capital Requirements Regulation (CRR).

1.2. Reminder on the basic principles for calculating the ratio

6 Pillar 1 of the new capital framework sets minimum capital adequacy requirements. In accordance with Article 2-1 of the Order of 20 February 2007 (amended), 8% of credit and dilution risk, market risk and operational risk must be covered by capital.

7 The European Capital Requirements Regulation (CRR) prescribes in Article 476 the maintenance of a floor during a temporary period starting with the entry into force of the regulation. Accordingly, credit institutions and investment firms shall keep their ability to calculate the risk-weighted assets according to the "Basel 1" rules (as determined in Regulations 91-05 and 95-02 of the Comité de la Réglementation Bancaire et Financière) and report correctly at line 2.6.1.a of the CA template of COREP reporting the amount of own funds requirements calculated in accordance with these regulations. The ACP will ensure that the own funds of credit institutions and investment firms are equal to or greater than 80 % of the amount reported in this line.

8 The 10% LGD floor established by Article 394(c) of the Order of 20 February 2007 (amended) shall cease to apply on 1 January 2013.

9 The denominator of the capital ratio is the sum of these risks, expressed as risk-weighted exposures in the case of credit risk, and as capital requirements multiplied by 12.5 in the case of operational and market risk.

10 The Order of 20 February 2007 (amended) prescribes a variety of methods and approaches for calculating the amount of risk-weighted exposures (for credit risk) and capital requirements (for market and operational risk), some of which require the prior approval of the ACP. The choice of methods and approaches used by institutions for each of these risks are independent from one another: for example, an institution that uses the Standardised approach for credit risk can opt for the Advanced Measurement Approach for operational risk.

11 In principle, the decision to move to a more sophisticated approach is irreversible (ratchet effect): an institution that adopts an internal models or advanced approach generally may not revert to a less sophisticated approach, except for demonstrated good cause and with the prior approval of the ACP (see Article 38-5 of the Order of 20 February 2007 (amended) for credit risk and Articles 361-2 and 363-2 for operational risk).

1.3. Scope and monitoring

12 The rules for supervising and monitoring capital adequacy are defined in Regulation 2000–03 relating to prudential supervision on a consolidated basis, in accordance with Article 1 of the Order of 20 February 2007 (amended). In principle, subject institutions are subject to supervision on both a consolidated basis and on a solo basis. However, the regulation permits exemptions from solo (or sub-consolidated) supervision for parent entities and for subsidiaries of institutions that are supervised on a consolidated basis, provided that certain conditions relating to the organisation and internal functioning of the group are satisfied. The ACP has specified the methods it will use to assess the satisfaction of those conditions.

1.3.1. Conditions for exemption of consolidated entities[6]

13 These conditions are set forth in Article 4.1 of Regulation 2000-03. As that article states, institutions that wish their subsidiaries to be exempted from solo supervision should provide the ACP with a list of the subsidiaries concerned, accompanied by a commitment as specified in paragraph (b) of Article 4.1. The declaration addressed to the ACP – which should be updated in the event of any modification to the list of the subsidiaries concerned – should be signed by one of the managers responsible for the institution and should take the following form.

"In order that the subsidiaries appearing on the enclosed list may benefit from the provisions of Article 4.1 of Regulation 2000-03 of the Comité de la Réglementation Bancaire et Financière, we declare to the Autorité de Contrôle Prudentiel that we will provide support to these subsidiaries to ensure their overall solvency and liquidity.

We will also ensure that they are managed prudently in accordance with banking regulation in force.

We will inform you in advance of any change that would alter the application of this declaration to a subsidiary that we no longer wish to benefit from the provisions of Article 4.1. In that event, this declaration will cease to apply to that subsidiary from the date that the Autorité de Contrôle Prudentiel states that the subsidiary fulfils the conditions for supervision on a solo or sub-consolidated basis."

14 This declaration must receive the prior approval of the institution's decision-making body, except where the responsible manager signing the declaration has received delegated authority to sign such a commitment without specific prior authorisation from the decision-making body, in which case notification of that body will considered sufficient. Accordingly, depending on the case, the declaration should end with one of the following two statements:

"We confirm that we have obtained the approval of the Board of Directors/Supervisory Board for this declaration" or *"We confirm that we have received delegations authorising us to make this declaration and that we have informed the Board of Directors/Supervisory Board of it".*

15 Given its importance, and in accordance with Article 381 of the 20 February 2007 Order (amended), which requires institutions to disclose how they have implemented Articles 4.1 and 4.2 of Regulation 2000-03, this declaration should be mentioned in the annexes to the consolidated financial statements of the parent institution.

1.3.2. Conditions for exemption of parent companies [7]

16 The conditions for exempting parent companies from solo supervision are set forth in Article 4.2 of Regulation 2000-03. Article 4.2 provides that two conditions must be satisfied:

– there is no material impediment to the transfer of capital or the repayment of liabilities to the parent company;

– the risk assessment, measurement, and control procedures within the meaning of Regulation 97-02 relating to internal control, implemented on a consolidated basis, cover the parent company

6. These conditions were communicated to the banking profession in two letters addressed to the president of the Association Française des Établissements de Crédit et des Entreprises d'Investissement (AFECEI), dated 18 April 2007 and 29 May 2007.

7. These terms were communicated to the banking profession in a letter addressed to the Association Française des Entreprises d'Investissement (AFEI), the Association Française des Sociétés Financières (ASF), and the Fédération Bancaire Française (FBF), dated 18 April 2007.

17 For the implementation of this article, the ACP has developed a set of criteria characterising the obstacles to the transfer of capital from subsidiaries to parent companies, an approach to determining whether or not an obstacle is material, and procedures for applying the exemption.

18 The criteria selected by the ACP for characterising obstacles to the transfer of capital from subsidiaries to parent companies are:

– *"Foreign exchange controls and political instability risks that could represent material obstacles to the transfer of capital from subsidiaries located in countries outside the European Economic Area."*

This criterion concerns only countries outside the European Economic Area. It does not apply to countries that are parties to the European Economic Area, since the legal system of the European Community prohibits any restrictions on the free movement of capital.

– *"The existence of legislation in the country in which the foreign subsidiaries are established which fails to provide the parent company a level of protection at least equivalent to that provided by the mechanisms for capital transfer governed by French company law."*

French law permits the use of various types of mechanisms for transferring capital or sharing of interests between companies in a group: mechanisms which do not involve a counterparty (distribution of dividends, partial early division of assets) and mechanisms which involve a counterparty or a common interest (centralisation of treasury functions, cash advances, and debt forgiveness).

– *"The existence of statutory or contractual clauses that impede the flow of capital from subsidiaries to the entities that exercise control."*

In addition to issues related to provisions of public policy, there should be no specific provisions in statutes or shareholder agreements that would prevent parent companies from upstreaming capital from their subsidiaries. In particular, in the case of subsidiaries under joint control, the mechanisms for exercising joint control should not impede the upstreaming of capital.

– *"The failure of a subsidiary to satisfy the capital requirements of the country in which it is established."*

This criterion is a direct consequence of the solo supervision exercised by the competent authorities in the country in which a credit institution or investment firm is established. The failure of a foreign-headquartered subsidiary to satisfy local capital standards could constitute an obstacle to the transfer of capital or to the repayment of its liabilities.

19 Only obstacles that are judged material are considered in assessing the transferability of capital. The criteria should be evaluated at the level of the group, in order to assess the situation of the parent company and determine whether management ratios shall be applied on a solo basis. For example, the fact that a small subsidiary triggers one of the above criteria would not by itself be considered a material obstacle to the transfer of capital from subsidiaries to the parent company. In view of the diversity of situations, the ACP has not established quantitative criteria for determining the significance of obstacles. In general, any situation likely to modify the assessment of the capital adequacy of the parent company would be considered material.

20 Regarding the mechanisms for applying the exemption, institutions shall declare, in a letter signed by a senior manager, that they satisfy the requirements of Article 4-2 of Regulation 2000-03, in terms of the criteria and the approach outlined above. This declaration should be transmitted only once, at the time of the implementation of the new capital framework. It should be revised in the event of any material change affecting the transferability of capital from

subsidiaries to the parent company. It need not be accompanied by a detailed list of countries; instead the institutions should keep the results of their analyses and their assessments of the materiality threshold at the disposal of the SGACP. The declaration should, however, be accompanied by the data called for in Article 69(4)(c) of Directive 2006/48/EC. Article 69(4) states that the competent authority shall publicly disclose, on an aggregate basis, by Member State:

- the amount of consolidated capital of the parent credit institution in a Member State which benefits from the exemption, that is held in subsidiaries in a third country;

- the percentage of total consolidated capital of parent credit institutions in a Member State which benefits from the exemption, that is represented by capital held in subsidiaries located in a third country;

- the percentage of total minimum capital required under Article 75 of Directive 2006/48/EC on a consolidated basis of parent credit institutions in a Member State which benefits from the exemption, that is represented by capital held in subsidiaries in a third country.

The data communicated by institutions in this regard, relating to the contributions to prudential consolidated capital made by subsidiaries located in countries outside the European Economic Area, may be estimated.

1.4. Authorisation process

21 The use of an Internal Ratings Based approach for credit risk, the Advanced Measurement Approach (AMA) for operational risk, or internal approaches for market risk and counterparty risk is subject to the prior approval of the ACP. This authorisation is intended to ensure that applicant institutions satisfy the minimum qualitative and quantitative requirements set forth in the regulations.

22 Applicant institutions should submit an application to the SGACP. The application is available in the International section of the ACP website. It describes in detail the procedure to be followed.

2. Methods for calculating regulatory capital

23 As noted in the introduction to this Notice, the elements listed below are not exhaustive. They complement the elements mentioned in Regulation 90-02 on capital (amended)[8]. Except where otherwise indicated, all regulatory citations in this part of the Notice refer to the abovementioned Regulation.

24 Regulatory capital consists of Tier 1 (core) capital, Tier 2 (supplementary) capital, and Tier 3 capital (short-term subordinated debt). (Note that this Notice uses the terminology used by market participants, which refers to ‘tiers’ of regulatory capital. It should be kept in mind that the Banking Directives use the equivalent terminology: ‘original, additional, and ancillary own funds’.) A number of deductions may be made – either from Tier 1 capital, or half from Tier 1 and half from Tier 2 – after application of the ceilings on each category.

25 The attention of subject institutions is drawn to the Basel Committee’s proposals concerning the definition of capital, which are designed to improve the quality of capital[9], as well as to the

[8] Regulation 90-02 of 23 February 1990 on capital amended by Regulations 91-05 of 15 February 1991, 92-02 of 27 January 1992, 93-07 of 21 December 1993, 94-03 of 8 December 1994, 98-03 of 7 December 1998, 2000-03 of 6 September 2000 and 2000-09 of 8 December 2000 and by the Orders of 24 May 2005, 19 September 2005, 3 March 2006, 20 February 2007, 11 September 2008, 29 October 2009, 25 August 2010, 29 December 2010 and 23 November 2011.

[9] Two press releases issued on 26 July and 12 September 2010 by the Group of Governors and Heads of Supervision, the governing body of the Basel Committee, approved the main elements of the December 2009 consultative document, “Strengthening the Resilience of the Banking Sector”, and set

arrangements relating to the timetable for implementing the new standards, as described in the press release published on 12 September 2010 and in the final and revised version of "Basel III: A global regulatory framework for more resilient banks and banking systems" published in June 2011.

2.1. Tier 1 (core) capital[10]

2.1.1. Items accepted without limit (Article 2(a))

26 Capital consists of ordinary shares/common stock, certificates of investment and *'certificats coopératifs d'investissement et d'associés (CCI et CCA)'*, '*parts sociales*' issued by mutual and co-operative institutions, and non-cumulative preferred shares (Article L.228-35-1 of the Commercial Code (Code de Commerce)) and preferred certificates of investment, excluding preferred shares without voting rights (Article L.228-35-2). Preferred shares directly-issued under the provisions of Article L.228-11 (and following Articles) of the Commercial Code may be included, subject to the prior approval of the ACP, in the elements that are eligible without a limit, provided that those preferred shares:

- are subject to an accounting treatment that is identical to the accounting treatment of ordinary shares;
- present a loss absorption capacity on a going concern basis;
- rank pari passu with ordinary shares in case of a liquidation.

27 Mutual and cooperative shares issued shall be considered equivalent to common shares since they fully satisfy the eligibility criteria set forth in EBA Guidelines, which are posted on the authority's website.

28 For the purposes of calculating consolidated capital, in application of Article 7 of Regulation 90-02 (amended), reserves shall include the full amount of positive goodwill and positive foreign currency translation reserves, along with creditor minority interests. The recognition of these creditor minority interests is explained below.

29 Differences arising from consolidation by the equity method are divided between reserves and retained earnings on the one hand, and interim profits on the other hand, as a function of the category of capital from which they originate.

2.1.2. Items accepted subject to a limit (Article 2(b))

30 Subject to the prior approval of the SGACP, hybrid instruments satisfying the eligibility criteria that are set forth in Regulation 90-02 (amended) and explained in the EBA Guidelines on Hybrid Capital and the 27 October 1998 Basel Committee press release on Instruments Eligible for Inclusion in Tier 1 Capital (cf. Annex A), such as super-subordinated securities issued under the provisions of Article L.228-97 of the Commercial Code as amended by the 1 August 2003 Law on Financial Security, and 'preferred securities' under Anglo-Saxon law, may be included in regulatory capital.

31 The limits on these instruments are defined in Article 5-I of Regulation 90-02 (amended).

32 'Innovative' hybrid instruments – i.e., instruments that provide a strong incentive for early redemption through step-up clauses, and dated instruments – are limited to a maximum of 15% of Tier 1 capital, subject to the prior approval of the SGACP, provided they satisfy the eligibility criteria for Tier 1 capital set forth in Regulation 90-02 (amended) and in the press release issued by

the timetable for implementing the Basel III reforms. The final document on the Basel III reforms was published on 16 December 2010. It recapitulates and expands upon the provisions of the December 2009 consultative document and the press releases.

10 In accordance with the 27 October 1998 press release of the Basel Committee on instruments eligible for inclusion in Tier 1 capital, which is reproduced in Annex A, certain hybrid instruments may be included in Tier 1 capital subject to the prior approval of the SGACP.

the Basel Committee on 27 October 1998 (cf. Annex A of this Notice). According to this press release, subject institutions should assess the level of the step-ups in reference to either the level of 100 basis points or 50% of the initial credit spread.

– Total hybrid instruments – 'innovative' and 'non-innovative' – are limited to 35% of Tier 1 capital.

– Instruments that are mandatorily convertible into common shares or other capital instruments in the event of a crisis, as defined in Paragraph (a) of Article 2 of Regulation 90-02 (amended), may exceed the 35% threshold, but may not exceed 50%.

33 In addition, a grandfathering clause provides for a gradual reduction over 30 years for hybrid instruments that have already been issued and that do not satisfy the new eligibility criteria (see Point II of Article 5 of Regulation 90-02 (amended)).

34 Minority interests arising from the consolidation of special purpose vehicles set up for the indirect issuance of hybrid instruments are included in either the 15% and 35% limits given above, depending on whether these instruments are innovative or not.

35 Minority interests that do not arise from the consolidation of special purpose vehicles set up for the indirect issuance of hybrid instruments are excluded from the above 35% limit. Minority interests carrying put options that settle in cash are not eligible for inclusion in Tier 1 capital.

36 Directly-issued preferred shares covered by Articles L.228-11 to L.228-20 of the Commercial Code that do not comply with the provisions of paragraph 26 of this Notice, are included within the 35% limit on Tier 1 capital provided they satisfy the eligibility criteria for Tier 1 capital defined in Annex A (Basel Committee 27 October 1998 press release: Instruments eligible for inclusion in Tier 1 capital). Directly issued preferred shares that provide a strong incentive for early redemption through step-up clauses are subject to the above 15% limit for 'innovative' hybrid instruments.

37 The hybrid instruments (issued directly or indirectly), preference shares, and minority interests mentioned above, taken together, may not represent more than 50% of Tier 1 capital.

38 Any redemption of items accepted subject to a limit should be submitted to the prior approval of the SGACP.

2.1.3. Deductions from Tier 1 capital (Article 2(c))

39 Intangible assets include negative goodwill; they do not include leaseholds. Goodwill deducted from Tier 1 capital also includes goodwill on interests accounted using the equity method.

40 Negative foreign currency translation reserves are also deducted from Tier 1 capital, along with debtor minority interests arising – in conformance with accounting rules – from net losses which the minority interest-holders have the capacity and the irrevocable obligation to cover through an additional investment.

2.1.4. Prudential filters

41 To implement the prudential adjustment of net unrealised gains stated currency by currency for capital instruments that are available for sale, deduct from Tier 1 capital the net impact on accounting capital of the unrealised gains or losses and all of the tax effects associated with them.

For example:

(1) In the event of the coexistence of an unrealised gain of 40 EUR and an unrealised loss of 20 EUR, assuming a tax rate of 33%, the amount to be deducted from Tier 1 capital would be equal to:

13.33 EUR if the institution has booked a deferred tax asset for the unrealised loss [i.e., (40 x 2/3) – (20 x 2/3)];

6.66 EUR if the institution has not booked a deferred tax asset for the unrealised loss [i.e., (40 x 2/3) – 20];

In either case, the amount that may be included in Tier 2 capital would be equal to 9 EUR [i.e., (40-20) x 45%].

(2) In the event of the coexistence of an unrealised gain of 40 EUR and an unrealised loss of 20 USD, again assuming a tax rate of 33%, the amount to be deducted from Tier 1 capital would be equal to 26.67 EUR [i.e., 40 x 2/3]. The amount that may be included in Tier 2 capital would be equal to 18 EUR [i.e., 40 x 45%].

2.2. Tier 2 (supplementary) capital

42 Tier 2 capital may be included only up to the limit of 100% of Tier 1 capital.

43 Tier 2 capital consists of upper Tier 2 capital and lower Tier 2 capital.

2.2.1. Upper Tier 2 capital

44 Upper Tier 2 capital includes that portion of the capital elements whose inclusion in Tier 1 capital is subject to ceilings which exceeds the limits set in paragraph 2.1.2 (Article 4).

45 The capital instruments referred to in Article 4(c) (including subordinated bonds which are convertible or redeemable only in shares) must satisfy the following four conditions:

a) they are subordinated[11] in capital and interest and fully paid up;

b) they are perpetual and cannot be redeemed early except at the initiative of the borrower and with the prior consent of the SGACP[12]. Under no circumstances should a request for redemption be made before a period of five years has elapsed, unless the redeemed borrowings are replaced with capital of equal or better quality;

c) they include a clause giving the borrower the right to defer payment of interest in the event that the profitability of the bank renders their payment inadvisable[13];

d) they are available to cover losses without the bank being obliged to cease operations.

11. The requirement that instruments be subordinated precludes them in particular from having "negative pledge" clauses, as noted in Bulletin 13 of the Commission Bancaire (November 1995).

12. The SGACP will grant approval if the request for redemption has been made at the initiative of the issuer, and if the redemption will not affect the solvency of the institution or new instruments of at least equal quality are issued simultaneously.

13. If the payment of interest is deferred, the payment of interest that was not paid on its regular due date may not take place before the next date on which interest is due.

46 All undated participating subordinated notes ('*titres participatifs*') and perpetual subordinated debt issued prior to 31 December 1988 are included in Upper Tier 2 capital, subject to the ceilings mentioned above. For new issuances, the debt contracts should be submitted for the approval of the SGACP.

47 When a hybrid instrument or an instrument of higher quality is part of a financing whose structure makes it impossible to determine with certainty if the instrument is perpetual, the instrument shall be classified as term subordinated debt. This policy, adopted by the Basel Committee on 26 May 1989, does not apply to instruments issued prior to that date.

48 When a perpetual subordinated debt instrument incorporates a clause providing for progressive escalation in the interest rate (TSIP or perpetual subordinated debt with interest step-up), the recognition of the perpetual character of the instrument shall depend on the limits placed on the step-up. The following cumulative limits shall be applied, subject to the approval of the SGACP:

- the interest rate may not increase by more than 75 basis points per stage;
- the increase in the interest rate may not exceed 75 basis points per five-year period. However, the accumulation of two five-year margins is permitted, resulting in a maximum increase of 150 basis points at the end of the tenth year of the life of the loan;

49 The inclusion of subordinated debt instruments in regulatory Tier 2 capital is subject to an examination of their conditions of remuneration by the SGACP. These limits shall be computed in terms of the market conditions prevailing at the pricing date. If the reference rate changes, the size of the step-up shall be measured by combining the spread over the variable rate to which it is indexed (EURIBOR, LIBOR, or similar reference rate) with the swap rate quoted at the time of issuance between that reference rate and the initial reference.

50 It should be noted that, as provided in Annex IV of Instruction 2007-02 (amended), institutions are required to submit issuance or debt contracts relating to items that are likely to be included in capital to the SGACP for its approval. This approval should be requested far enough in advance – approximately two weeks – to allow an in-depth review of the request by the SGACP; and approval be obtained in writing prior to issuing the instruments in question. The request should be based on the final terms of the contracts or on terms that do not differ significantly from the final version. The application of this procedure will avoid the risk that instruments that have already been issued are denied eligibility for inclusion in the level of capital envisaged by the institution.

51 Moreover, when under the issuance or loan contract the institution has the possibility to redeem by anticipation part or all of its debt, the decision to use this option is subject to the prior approval of the SGACP. This approval is also required in the case of early amortisation of subordinated instruments by means of a takeover bid or share exchange offer. The repurchase on the stock exchange of subordinated instruments must also be submitted to the prior approval of the SGACP, if a significant proportion, around 10% of the issued instruments, is cancelled using this method.

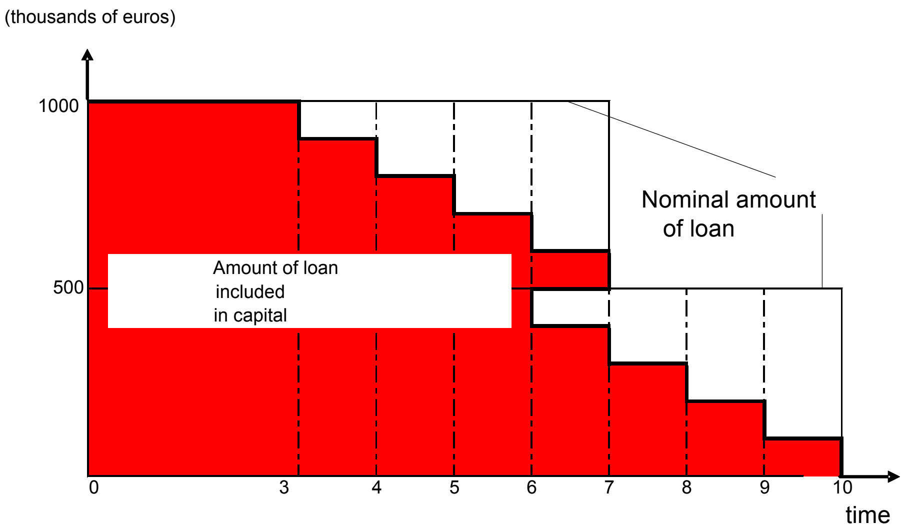
2.2.2. Lower Tier 2 capital (Article 4(d))

52 This category includes term subordinated debt instruments whose initial maturity is greater than or equal to five years, applying a cumulative annual amortisation factor when the residual life of the instrument falls below five years. In the event of a difference between the life of the contract and fund drawdown dates, only drawdown dates may be used to determine the effective maturity of the instrument, insofar as only funds that are effectively drawn may be included in prudential capital. Early redemption of these instruments is permitted, with the approval of the SGACP. However, under no circumstances should a request for redemption be made before a period of five years has elapsed, unless the redeemed borrowings are replaced with capital of equal or better quality. Furthermore, redemption must not occasion payment of compensatory indemnification by the borrower.

53 Subordinated debt that is convertible to or redeemable in shares or cash is treated as equivalent to shares or cash.

54 For the rate of amortisation in the last five years of a subordinated debt instrument, two cases are possible. For instruments that are redeemed in full at maturity, in principle the amortisation rate is set at 20% per year. For instruments that are redeemed on a predetermined annual schedule, the security or subordinated loan is broken down into as many tranches as there are redemption dates and a straight line discount of 20% per year is applied to each tranche.

55 To illustrate the latter case, consider the example of a subordinated loan in the amount of EUR 1 million with an initial maturity of 10 years and redemption of half the principal after seven years. The amount included in capital is indicated in the diagram. In this example, at the end of six years the amount of the loan included in capital is 20% of 500,000 plus 80% of 500,000 = EUR 0.5 million. In other words, the discount is 50% in the seventh year.



56 The preceding limits on step-ups for perpetual hybrid capital instruments are reduced in the case of term subordinated debt to 50 basis points per adjustment and per period of five years, without the option of combining two five-year periods. When the step-up is greater than 50 basis points, the date of the step-up is considered as the final maturity of the loan for the purposes of calculating the discount. The inclusion of subordinated debt instruments in regulatory Tier 2 capital is subject to an examination of their conditions of remuneration by the SGACP.

57 For supplementary capital and for Tier 1 items accepted subject to a limit, the principle of a transfer by the debtor (or by the issuer in case of subordinated debt issuance) of its rights and obligations is authorised in the framework of a contractual clause when it enables a reallocation of own funds within the group in compliance with the prudential requirements in force. In this respect, rights and obligations related to the contract can only be transferred to another institution belonging to the same group and to the prudential scope of consolidation of this group. The transfer of rights and obligations, which is analysed from an economic point of view as the possibility to redeem by anticipation or to repurchase own funds, is subject to the same conditions as prepayments and repurchases, and in particular, is subject to the preliminary approval of the SGACP.

58 Capitalised interest on subordinated debt is eligible for inclusion in lower Tier 2 capital, provided that it has the same degree of subordination as principal on the debt and that the residual maturity of capitalisation is at least five years. Capitalised interest is subject to a prudential discount of 20% per year in the last four years of the period of capitalisation.

59 All of the instruments in this category of term subordinated debt may be included in capital only up to the limit of 50% of the amount of core capital.

2.3. Deductions

60 Deductions are made half from Tier 1 capital and half from Tier 2 capital. The calculation for the two categories of capital is made after applying the ceilings applicable to each category.

2.3.1. Equity investments in banking sector entities (Article 6(I))

61 The following items are deducted:

- loans, participating notes, and subordinated debt made to (or issued by) the institutions referred to in points i) through iii) of paragraph f) of Article 1 of Regulation 2000-03 of 6 September 2000. The amount of term subordinated debt to be deducted is calculated after applying the cumulative annual discount of 20% when the remaining maturity falls below five years. The amount corresponding to the discount must be recorded as an exposure and included in the denominator of the ratio. Participating notes and subordinated debt issued and then repurchased by the institution are included in the deduction;
- shares, preferred shares, and '*parts sociales*' issued by the institutions referred to in points i) through iii) of paragraph f) of Article 1 of Regulation 2000-03 of 6 September 2000;
- super-subordinated securities issued by the institutions referred to in points i) through iii) of paragraph f) of Article 1 of Regulation 2000-03.

62 The deduction applies to all securities constituting capital (or its equivalent) of institutions referred to in points i) through iii) of paragraph f) of Article 1 of Regulation 2000-03 of 6 September 2000, even when they carry a guarantee provided by a third party outside the banking system. When such a guarantee is provided by a credit institution or investment company, it should be deducted from the capital of the guaranteeing institution instead of that of the institution holding the securities in question, regardless of the credit rating of the guaranteeing institution.

2.3.2. Equity investments in insurance entities (Article 6(II))

63 Equity investments (within the meaning of Article L. 511-20 II of the Monetary and Financial Code (Code Monetaire et Financier) in entities in the insurance sector, along with subordinated claims and any other capital instruments in such entities, are deducted from capital using one of the following methods.

64 Method 1: an institution identified as a financial conglomerate by the ACP shall deduct from Tier 1 capital the positive contribution to consolidated earnings and reserves generated by entities in the insurance sector, including positive equity-method adjustments; negative equity-method adjustments are not included. The non-deducted portion of these equity investments (i.e. the equity-method value less the equity-method adjustment) should be weighted as an equity exposure at the rate used under the approach (Standardised or IRB for credit risk) applied to the institution as provided for under Articles 23 and 57-1 *et seq.* of the Order of 20 February 2007 (amended).

65 Method 2: an institution that does not belong to a financial conglomerate (or that has not voluntarily opted to use the first method) shall deduct from its capital the amount of securities accounted using the equity method in equal proportions from Tier 1 and Tier 2 capital.

66 The deduction of positive equity-method adjustments for equity investments in insurance companies from the calculation of Tier 1 capital, in application of paragraph 4 of Article 7, should exclude goodwill already deducted, to match the treatment of securities consolidated by the equity method deducted from capital (see paragraph 5 of Article 7). This deduction of positive equity-method

adjustments should be carried out line by line (i.e., without netting of positive and negative adjustments).

2.3.3. Non deduction of equity investments in banking sector entities (Article 6 (III))

67 As concerns institutions that are consolidated globally for the determination of capital requirements of mutual or cooperative banking groups, Article 6 III of Regulation 90-02 (amended) is applied to intra-group equity investments held by such institutions in the form of '*certificats coopératifs d'investissement (CCI)*' or *'certificats coopératifs d'associés (CCA)'* for the calculation of own funds. The capital elements that are not deducted are included in risk-weighted assets.

2.3.4. Prudential treatment of positive and negative differences between provisions and expected losses under the Internal Ratings Based (IRB) approach

68 Implementing Articles 4.e) and 6 quarter of Regulation 90-02 (amended), subject institutions must offset the positive and negative differences between provisions and expected losses calculated for the various portfolios. Only the resulting amount of this offsetting is then subject to a prudential adjustment: either a deduction made half from Tier 1 capital and half from Tier 2 capital or an integration into Tier 2 if the final difference is positive.

2.4. Tier 3 capital

69 Tier 3 capital may be used only to cover market risk, subject to the following limits:

- eligible Tier 3 capital will be limited to 250% of residual Tier 1 capital, that is, the Tier 1 capital that remains available after credit risk and operational risk have been covered. This means that at least 2/7 (or approximately 28.6%) of market risk must be covered by Tier 1 capital that is not used to cover credit risk and operational risk;
- residual Tier 2 capital may be substituted for Tier 3 capital within the same limit of 250%, as long as the overall limits established in the 1988 Basel Accord are not exceeded: the amount of Tier 2 capital may not exceed total Tier 1 capital, and the amount of long-term subordinated debt may not exceed 50% of Tier 1 capital.

3. Methods for calculating the denominator of the capital ratio

70 Unless stated otherwise, the regulatory references in this section of the Notice are references to the 20 February 2007 Order (amended) relating to capital requirements for credit institutions and investment firms.

The contents of this section of the Notice are derived from the responses to questions received by the CRD Transposition Group (CRD TG), a working group created at the initiative of the European Commission with the goal of ensuring the homogeneous application of the CRD throughout the European Union. The entire set of responses provided by the CRD TG is available on the website of the European Commission, and also on the website of the European Banking Authority (EBA).

3.1. Credit risk

3.1.1. Standardised approach

3.1.1.1. Prudential treatment of exposure classes

71 Each exposure (or, in certain cases, each part of an exposure) evaluated using the Standardised approach must be assigned to one of the exposure classes defined in Chapter II of Title II and listed below, in order to assign it a risk weight (see Article 8-1).

72 Each exposure is classified in one of the following categories:

- exposures to central governments and central banks (Article 11);
- exposures to regional governments and local authorities (Article 12);
- exposures to public sector entities (Article 13);
- exposures to multilateral development banks (Article 14);
- exposures to international organisations (Article 15);
- exposures to institutions (Article 16);
- corporate exposures (Article 17);
- retail exposures (Article 18);
- real estate loans granted for the acquisition or improvement of residential property and secured by a first mortgage or equivalent collateral (Article 19);
- exposures arising from finance lease agreements or lease agreements of a financial nature concerning commercial real estate expositions (Article 21);
- past-due exposures (Article 22);
- high-risk exposures (Article 23);
- real estate bonds and other assets benefiting from the preference mentioned in subparagraph 2 of paragraph I of Article L. 515-13 of the Monetary and Financial Code, along with similar bonds issued by an institution whose head office is in a Member State (Article 24);
- exposures to securitisation positions (Article 25);
- exposures in the form of investments in units in Collective Investment Undertakings (Article 26);
- other items (Article 27).

73 The rules for assigning exposures should be unambiguous and consistent over time, and institutions should be able to justify their classifications. All of the exposure classes are independent: each exposure (or part of an exposure) must be assigned to a single exposure class at a given point in time.

74 The default risk weight for exposures under the Standardised approach is 100% (Article 8.2). The unexplained differences between the accounting data and the data stemming from risk-databases that institutions are not capable of assigning to the relevant exposure classes – on a sufficiently justified and documented basis – are subject to this default risk weight of 100%.

Exposures to central governments and central banks (Article 11)

75 Tables for mapping between the credit quality steps cited in Article 11(b) and the credit assessments produced by external credit assessment institutions recognised by the ACP are provided in Annex C of this Notice.

76 The use of credit assessments issued by a credit export agency is permitted provided the agency satisfies the conditions set forth in Article 11(g). There is no formal recognition process for these agencies; it is up to each institution to ensure that the agency whose credit assessments it uses satisfies the conditions.

77 Exposures to central governments and central banks that are denominated and funded in the domestic currency are risk-weighted at 0% (Article 11(d)). In order to apply this provision and consider the exposure to be funded in the domestic currency, the institution must have corresponding liabilities denominated in the domestic currency of the central government or central bank. Institutions that make use of this provision should be able to demonstrate their compliance with this requirement.

78 For the application of Article 11(e), institutions may apply the risk weights assigned by OECD member countries.

Exposures to Public Sector Entities (Article 13)

79 A list of French public sector entities treated as exposures to central governments and central banks in accordance with Article 13(a) of the Order of 20 February 2007 (amended) is provided in Annex B1 of this Notice. These entities are risk-weighted at 0%.

80 A list of French public sector entities considered as institutions, in accordance with Article 13(a) of the Order of 20 February 2007 (amended), is provided in Annex B2 of this Notice. These entities are risk-weighted at 20%.

81 For the application of Articles 12(c) and 13(c), institutions may apply the risk weights assigned by OECD member countries.

Exposures to institutions (Article 16)

82 Tables for mapping between the credit quality steps cited in Article 16(a) (the credit quality step of the State in which the institution that is counterparty to the exposure is incorporated) and the credit assessments produced by external credit assessment institutions recognised by the ACP are provided in Annex C of this Notice.

83 The risk weighting of foreign establishments that belong to a group depends on their nature. Subsidiaries of institutions are risk-weighted according to the rating assigned by the central government of the country that authorises the subsidiary. Branches are weighted as a function of the rating assigned by the central government of the country where the parent institution is located.

Corporate exposures (Article 17)

84 Tables for mapping between the credit quality steps cited in Article 17(a) and (c) and the credit assessments produced by external credit assessment institutions recognised by the ACP are provided in Annex C of this Notice.

85 For exposures to foreign corporates which belong to a group and which do not have an external credit assessment, the regulatory treatment depends on the nature of the company (see Article 7(b)):

– if the corporate is a subsidiary, the risk weight to be applied is the higher of 100% and the risk weight that applies to the central government of the State in which the subsidiary is incorporated;

– if the corporate is a branch, the risk weight to be applied shall be the higher of 100% and the risk weight of the central government of the State in which the parent company is incorporated.

Retail exposures (Article 18)

86 To be eligible for inclusion in the retail exposure class, each exposure must “be one of a significant number of exposures managed in a similar fashion” (Article 18(a)(ii)). This criterion is meant to ensure that the retail exposure class is composed of a large number of exposures with similar characteristics, so that the risks associated with each individual exposure is greatly reduced (granularity criterion). Institutions are responsible for establishing procedures that ensure that the number of exposures with similar characteristics is sufficiently large for the risks to be substantially reduced. In contrast with the treatment of retail exposures in the Internal Ratings Based approach, retail exposures may in certain circumstances be managed individually.

87 The term “entities” used in Article 18 obviously includes companies, but it may also include other types of entity (for example, associations). Consistent with the IRB approach, the ceiling of EUR 50 million in total annual sales may be used to qualify exposures as SME rather than corporate exposures. The inclusion of an exposure to an SME in the retail exposure class assumes not only that the total annual sales of the SME are less than EUR 50 million, but also that the two other criteria mentioned in Article 18 are satisfied (the exposure is one of a significant number of exposures managed in a similar fashion, and the total amount owed by the obligor or by the same beneficiary to the subject institution or to one of the entities of the group to which it belongs does not exceed EUR 1 million).

88 Article 18(a)(iii) states that past-due exposures should be included in applying the limit of EUR 1 million. All past-due exposures are to be taken into account, regardless of how long they have been past due (i.e., past-due exposures are not limited to those referred to in Article 22).

89 The term “the total amount owned” used in Article 18(a)(iii) for applying the limit of EUR 1 million means that off-balance-sheet exposures are not taken into account in calculating the limit.

Exposures in the form of residential real estate loans (Article 19)

90 The treatment set forth in Article 19 for exposures in the form of real estate loans granted for the acquisition or improvement of residential property secured by a first mortgage or equivalent collateral is independent of the nature of the counterparty (i.e., this treatment is not limited to loans made to individuals, reflecting the fact that this exposure class is not a sub-category of the retail exposure class).

91 The portion of exposure that is not risk-weighted at 35% (i.e., the portion of exposures that exceeds the 80% loan-to-value ceiling mentioned in Article 19(c)) should be treated like any other exposure. In particular, this portion may be risk-weighted at 75% provided the conditions set forth in Article 18 are satisfied. Consequently, real estate loans, and the portions of real estate loans that are not eligible for the 35% risk weight but which are included in the retail exposure class and risk-weighted at 75%, should be taken into account when applying the EUR 1 million threshold in Article 18(a)(iii).

92 In the Standardised approach, guaranteed loans are not treated as real estate loans secured by collateral equivalent to a first mortgage, and therefore do not benefit from the 35% risk weight specified in Article 19, without prejudice of the following provisions of this paragraph. They should be treated as ordinary exposures; however the guarantee may give rise to a reduction in the capital charge through the application of the credit risk mitigation techniques set forth in Title IV of the Order of 20 February 2007 (amended). In the case of institutions that have applied for the Internal Ratings Based approach for credit risk for their retail portfolio, house loans guaranteed by an insurance company may be considered, subject to the prior approval of the ACP, as house loans secured by a mortgage equivalent collateral for the purposes of the Standardised approach. In this case, a risk weight of 35% shall be applied. This option may only be used in the case of a mortgage commitment on first demand, provided that the rating of the insurance undertaking is at least equal to A- and that this treatment is applied to all equivalent loans that are secured by such an insurance company.

93 A mere mortgage commitment, on its own, is not considered as equivalent collateral.

94 Exposures in the form of real estate loans covered by the program of social guarantees for residential real estate loans (the '*Fonds de Garantie Sociale* – FGAS') are risk-weighted at 15%. When these exposures are considered as impaired according to Article 22(b) of the Order of 20 February 2007 (amended), they are also risk-weighted at 15%, the 100% risk-weight provided in Article 22(b) applying to the non-hedged part of the asset (15% of the exposure), and the risk-weight of 0% applying to the hedged part of the asset (85% of the exposure).

Exposures arising from finance lease agreements or lease agreements of a financial nature involving commercial real estate (Article 21)

95 The Order of 20 February 2007 provides that in the Standardised approach, under Article 7-7 of the Order, "the exposure value of finance lease agreements and lease agreements of a financial nature can be decomposed into two elements: the discounted value of minimum lease payments, and, where applicable, a fraction of the residual value at risk equal to 1/t, where t is equal to the greater of 1 and the number of years remaining in the term of the agreement. These two elements shall be assigned different risk weights, with the discounted value of the residual value being treated as a tangible asset". This provision also applies to moveable property.

96 Furthermore, in the Standardised approach, "any fraction of residual value at risk included in the exposure value of the agreement shall be risk-weighted at 100%" in accordance with Article 21(a) of the Order of 20 February 2007 (amended). This provision also applies to moveable property. The exemption provided in Article 21(c) is not an individual exemption that the ACP will apply on a case by case basis as a function of the circumstances of specific institutions. It is a general exemption relating to conditions in the real estate market which, when granted, will apply to all institutions that satisfy the conditions set forth in paragraphs (i) and (ii).

Past-due exposures (Article 22)

97 Once an exposure is past due by more than 90 days or by more than the number of days defined in Title X, the full amount of the exposure, and not just the past-due amount, shall be considered as belonging to the past-due exposure class.

98 The specific treatment of past-due exposures applies from the time that the past-due period exceeds a predetermined number of days. This number of days is calculated in relation to the applicable reference date under the contractual terms in effect for the exposure at the time it becomes past due, and therefore may reflect the effect of any restructuring.

High-risk exposures (Article 23)

99 The "equity exposures" mentioned in Article 23(a) present the characteristics stated in Annex D. The "high-risk exposures" mentioned in Article 23(b) correspond to exposures that are normally risk-weighted at 150% under the Standardised approach (for example, corporate exposures associated with credit quality step 5 or 6, or sovereign exposures associated with credit quality step 6). These exposures, normally risk-weighted at 150%, may benefit from the preferential risk weights set forth in Article 23(b) if they are sufficiently provisioned and are not more than 90 days past due. In the latter case, these exposures are risk-weighted according to Article 22.

Exposures in the form of investments in units in Collective Investment Undertakings (Article 26)

100 Article L214-1 of the Monetary and Financial Code lists the different categories of CIU. Note that securitisation entities that have issued only one category of units are treated for prudential purposes as CIUs.

101 Tables for mapping between the credit quality steps referred to in Article 26(a) and the ratings of external credit assessment institutions recognised by the ACP are provided in Annex C of this document.

3.1.1.2. Treatment of off-balance sheet items

102 In accordance with Article 7-2, off-balance sheet items are assigned to risk classes according to their characteristics. This classification is detailed in Annex I of the Order of 20 February 2007 (amended).

103 The category "other items carrying a high risk" in Annex I of the Order of 20 February 2007 (amended) includes:

- financial standby letters of credit. This category includes payment or repayment guarantees;
- counter-guarantees provided to credit institutions covering exposures to other credit institutions;
- repayment guarantees covering loans extended by other credit institutions;
- substitutions for a counterpart 'decredere' ('*ducroires*');
- securities due[14]. This category includes commitments net of retrocessions relating to securities issues, underwriting guarantees, or other investment guarantees, as well as purchases in securities futures markets up to the settlement date for the securities;
- temporary asset sales[15] in which the bank retains the credit risk (i.e., there is a strong probability that the selling bank will repurchase the asset[16]);
- forward asset purchases and unpaid purchases of shares and other securities.

14. These instruments should be risk-weighted based on the type of assets and not on the category of the counterparty to the transaction.

15. This is the case for transactions in which interest or coupons, but not principal, are indexed to a reference portfolio, or for securities for which only the payment of principal on the contractually agreed date is guaranteed (claims of a "composite" nature).

16. In particular, sales with repurchase rights referred to in Article 4-II of Regulation 89-07 (sales with repurchase option).

104 The category "other items carrying a medium risk" in Annex I of the Order of 20 February 2007 (amended) includes:

– performance standby letters of credit, including guarantees of performance, completion, contract execution, and repayment of deposits, bids, or contract holdbacks;

– project finance commitments;

– lines of credit that can be drawn in several segments, if any of the segments is longer than one year; however, the segments may be considered separately if there is no possibility of transfer between them and if they serve distinct and independent purposes;

– commitments of more than one year in an amount that varies seasonally (the credit conversion factor applies to the maximum amount of the commitment);

– commitments of indefinite maturity, or renewable commitments that the bank can cancel unconditionally at any time after a notice period ('evergreen' commitments);

– backup lines for commercial paper;

– guarantees provided by the presenting institution for the payment of cash compensation payable by the initiator in a purchase of securities as part of a takeover bid or exchange offer.

105 The category "other items carrying a moderate risk" in Annex I of the Order of 20 February 2007 (amended) includes:

– guarantees (other than on first demand) of contract execution, bids, or contract holdbacks, taking the form of surety bonds;

– commitments that can be renegotiated at the end of a period of at most one year, if the renegotiation procedure involves a complete new review of the financial structure of the beneficiary and if the bank has complete discretion not to renew the commitment;

– guaranteed administrative or tax bonds;

– EC surety bonds ('*cautions communautaires*');

– commitments provided to CIUs to guarantee their capital or return;

– surety bonds prescribed by laws governing financial guarantees required to practice certain professions, including surety bonds covering the restoration of mine sites;

– guarantees covering the financing of takeover bids.

106 The category "other items carrying a low risk" in Annex I of the Order of 20 February 2007 (amended) includes:

– simple exchange offer tenders, provided that the commitment is included in the bank's off-balance accounts and the bank can confirm the magnitude of its commitment.

3.1.1.3. Recognised external credit assessment institutions

107 Among the new provisions introduced in the methods for calculating the capital ratio is the option, for credit institutions and investment firms, in certain well-defined cases, to use the assessments produced by external credit assessment institutions (ECAIs).

108 In accordance with Article L. 511-44 of the Monetary and Financial Code, the ACP has published a list of external credit assessment institutions whose assessments may be used by credit institutions and investment firms for the purposes of implementing the new capital regulations. This list specifies, for each ECAI, the credit quality steps to which the assessments issued by the institution corresponds.

109 The following seven institutions have been recognised as ECAIs in France:

– Banque de France[17];

– Coface[18];

– Dominion Bond Rating Service;

– Fitch Ratings;

– Japan Credit Rating Agency;

– Moody's Investors Services;

– Standard & Poor's Ratings Services.

110 The scope of recognition of each of these institutions, along with tables for mapping between the regulatory credit quality steps and the external ratings issued by each ECAI, are provided in Annex C of this Notice[19].

111 The decision to grant recognition followed the recommendations of EBA, and for several of these institutions, was made jointly with other European countries. Other external credit assessment institutions seeking to be recognised in France should submit an application. The procedures for submitting applications are explained on the website of the Banque de France.

3.1.1.4. Use of external ratings

112 When an institution that has designated one or more ECAIs recognised by the ACP does not have at least one external credit assessment issued by one of these ECAIs (i.e. when the ECAI or ECAIs designated by the institution have not issued a credit assessment for the exposure in question, and the assessment of another ECAI has not been obtained), that institution shall apply the default risk weight for the exposure class in question, which is normally 100%. The provisions of Chapter IV relating to the use of external credit assessments (in particular, Articles 36(1), 36(2) and 37(1)) apply to institutions only to the extent that assessments are produced by recognised and designated institutions.

113 In accordance with Article 37-3, external credit assessments that apply to a firm that is part of a group may not be used for other entities within the group. This rule applies in both directions: the assessment of a subsidiary may not be applied to the parent entity, and vice versa. This rule also applies to special purpose vehicles: ratings of special purpose vehicles set up to conduct a particular issuance may not be applied to the parent entity.

114 When there is no short-term credit assessment for a given exposure, the risk weight may be based on long-term credit assessments, subject to the general provisions of Article 37-2 (and subject to provisions of the third and fourth paragraphs of Article 37-4 if other short-term exposures are rated).

17. Since the rating methodology of the Institut d'Émission des Départements d'Outre Mer (IEDOM) is similar to that of the Banque de France, institutions may use its credit assessments subject to the same conditions.

18. Institutions will no longer be able to use COFACE assessments after the entry into force of the CRR because only external credit assessments issued by an eligible ECAI may be used to calculate capital requirements (cf. Article 130 of the draft CRR and EU Regulation 1060/2009 on credit rating agencies).

19. This information is also available on the ACP website in the International section under Supervisory Disclosure – Rules and Guidance.

3.1.2. Internal Ratings Based approach for credit risk

115 In order to be authorised by the ACP to use the Internal Ratings Based approach, institutions must satisfy the minimum requirements (both qualitative and quantitative) set forth in Title III of the Order of 20 February 2007 (amended). For more detailed information on these requirements, institutions can refer to the "Guidelines on the implementation, validation and assessment of Advanced Measurement (AMA) and Internal Ratings Based (IRB) Approaches" published by CEBS/EBA on 4 April 2006.

3.1.2.1. Definition of exposure classes

116 Each exposure treated using the Internal Ratings Based approach shall be assigned to one of the seven exposure classes listed in Article 40-1: (a) central governments and central banks, (b) institutions, (c) corporates, (d) retail, (e) equity, (f) securitisation positions, and (g) other non-credit obligation assets. The rules for assignment should be unambiguous and consistent over time, and institutions should be able to justify their classifications. All of the exposure classes are independent: each exposure (or part of an exposure) must be assigned to a single exposure class at a given point in time.

117 The 'corporate' exposure class is the default exposure class for credit exposures (Article 40-5). The unexplained differences between the accounting data and the data stemming from risk-databases that institutions are not capable of assigning to the relevant exposure classes – on a sufficiently justified and documented basis –- are subject to a default risk weight of 100%.

118 Pending European harmonisation on the subject, cash items in the process of collection shall be classified as non-credit obligation assets and risk-weighted at 100%.

Retail exposures (Article 41): general rules

119 The 'retail' exposure class is divided into three sub-classes:

– the sub-portfolio of real estate loans secured by a mortgage or equivalent collateral,

– the sub-portfolio of revolving exposures to retail customers,

– other exposures to retail customers.

120 The 'other exposures' sub-class is the default sub-class for eligible retail exposures. Assignment to the other two sub-portfolios is subject to specific conditions.

121 Exposures to natural persons and exposures to small and medium-sized entities may be assigned to the retail exposure class. The term 'small or medium-sized entity' should be interpreted broadly, to include 'professionals' classified in the retail portfolio. Thus the EUR 1 million threshold applies to individual entrepreneurs. Similarly, partnerships, whatever their nature and their purpose, are treated as entities, and exposures to partnerships should be included when applying the EUR 1 million threshold.

122 Subject groups calculate the EUR 1 million threshold on a consolidated basis, even if the different entities of the group concerned by the exposure do not apply the same prudential approach for credit risk (Standardised or Internal Ratings Based approach).

Retail exposures: real estate loans

123 The definition of this sub-portfolio differs in several respects from the definition of the real estate loan exposure class in the Standardised approach (Article 19):

– There are no restrictions on the quality of the mortgage, since differences in quality between exposures are reflected in the estimates of risk parameters (for LGD in particular). For example, while a first mortgage is required in the Standardised approach, no such requirement is imposed in the IRB approach. Thus loans secured by second mortgages are eligible for inclusion in this sub-portfolio, provided the actual degree of protection provided by second mortgages is reflected in the institution's estimates of LGD;

– Similarly, there are no requirements in terms of loan-to-value (the ratio of the exposure amount to the value of the collateral), since any shortfalls in coverage are reflected in historical loss data and thus in LGD;

– Guaranteed loans are eligible for inclusion in this sub-portfolio, in contrast with the treatment under the Standardised approach.

124 The principal determinant of assignment to this sub-portfolio, in addition to the presence of a mortgage or equivalent collateral, is thus the purpose of the loan. Only housing loans (residential real estate) are eligible for inclusion in this sub-portfolio. Consequently, the presence of a mortgage is not a sufficient condition for assigning a retail loan to the real estate loan sub-portfolio.

Retail exposures: revolving exposures

125 Financing for individual entrepreneurs, professionals, or craftsmen is not eligible for inclusion in the revolving retail exposure class, since this sub-portfolio is limited to exposures to natural persons (Article 54-4), with the term 'natural person' understood in its economic sense to mean an individual who is not borrowing to finance a professional activity.

Equity exposures (Article 42)

126 Article 42 defines equity exposures as exposures that confer a subordinated, residual claim on the assets or income of the issuer, or that have a similar economic substance. Assignment to this exposure class should be on the basis of economic substance, and should not be limited to instruments specifically identified as shares. All instruments whose characteristics match this definition (such as certain subordinated securities or callable bonds) should be included.

127 In practice, all instruments that fit the definition of 'capital instruments' as that term is used in the IFRS standards are included in the equity portfolio. Also included are those instruments which, independent of accounting rules, would be considered prudentially as belonging to the equity portfolio by virtue of the definition in Article 42: in particular, Tier 1 capital instruments, as well as the Tier 2 capital instruments referred to in Article 4(c) of Regulation 90-02 (amended) which are not deducted.

128 A detailed discussion of the characteristics of instruments that are eligible for inclusion in the equity portfolio is provided in Annex D of this Notice.

129 A risk weight of 100% may be applied to some holdings in institutional bodies. According to the policy adopted at the European level, equity investments are eligible for this treatment if they satisfy the following criteria:

– the purpose of the investment is to permit or facilitate the business of the institution, rather than to generate earnings;

– the risk of default is less than for an ordinary equity investment because the institution has influence over the entity's business (as a customer for its products or services) or because the entity in question provides infrastructure to a number of market participants which are likely to be implicitly committed to a joint support of the undertaking.

130 These investments are treated as other non-credit obligations. In France, this category includes investments in the Société de Financement de l'Économie Française (SFEF), Euroclear, Euronext NV, LCH Clearnet Limited, and Sicovam Holding SA.

131 In both the Simple Risk Weight (Article 58-1) and Internal Models (Article 59-1) approaches for equity exposures, a risk weight of 190% is applied to exposures in the form of private equity investments held in sufficiently diversified portfolios. Institutions making use of this provision should be able to justify the diversified nature of their portfolio.

132 Whether or not a private equity portfolio is sufficiently diversified can be assessed using a set of criteria, considered as indicators of diversification:

– several stages of investment (start-up, creation, venture capital, development, transmission, mezzanine, turnaround, etc.),

– multiple vintages (indicate steady investment activity over several years),

– multiple business sectors (food processing, manufacturing, services, telecommunications, biotechnology, etc.),

– multiple vehicles (funds with different maturities, funds of funds, etc.),

– multiple regions or countries,

– concentration of exposures (the share represented by the largest investment, by the ten largest investments, etc.).

133 Article 394(d) permits institutions to assign a 150% risk weight to their private equity investments – with the exception of financing for leveraged buy-outs – under certain conditions and during a limited transition period. An economic approach to the definition of LBOs is used to identify LBO financings within the exposure class of private equity investments; there is no legal or fiscal definition. Institutions should be able to show that no LBO financings are included in the exposures benefiting from the grandfather clause. It should be possible to use internal organisation (business lines) or internal classifications to identify LBO financings.

Exposures in the form of investments in units in Collective Investment Undertakings (CIUs)

134 Article L214-1 of the Monetary and Financial Code lists the different categories of CIU. Note that securitisation entities that have issued only one category of units are treated for prudential purposes as CIUs.

135 Exposures in the form of investments in units of CIUs may be treated using a 'look-through' approach if certain conditions are met (Article 63-1). In other words, the underlying exposures of the CIU units may be treated as direct exposures of the institution. If the underlying exposures belong to an exposure class for which the institution has received authorisation to use an Internal Ratings Based approach, that approach should be applied to the underlying exposures. If, on the other hand, the underlying exposures belong to an exposure class for which the institution uses the Standardised approach, as part of a phased 'roll-out' of the IRB approach, or in connection with 'partial use', the institution should risk-weight them using the methodology of the Standardised approach. Finally, if the underlying exposures are not covered by a roll-out or partial use and the institution is unable to apply the IRB approach (for example, because of a lack of data), the institution should apply the treatment set forth in Article 63-2.

136 When the conditions for 'look-through' treatment are not satisfied, exposures in the form of investments in units of CIUs may be risk-weighted using either of the following two methods.

– The method described in Article 64, which can be seen as the default treatment, applies the Simple Risk Weight approach for equity exposures to the underlying exposures of the CIU units. On the basis of the limited information available to it, the institution should assign the equity exposures to one of the three risk-weight categories defined in the Simple Risk Weight approach. If the information provided, for example in the CIU's investment mandate, is not sufficiently detailed to distinguish between the three risk-weight categories, the exposures should be assigned to the 'other equity exposures' category. The same principle applies to other exposures (non-equity exposures such as debt securities), which should be assigned to one of the three categories of equity according to their characteristics. If the underlying exposures are publicly traded, the risk weight for 'exchange traded equity exposures' may be used. If they are not publicly traded or if the nature of the exposure is unknown, they should be risk-weighted as 'other equity exposures'. In principle, no exposure (except those in the equity exposure class) should be assigned to the category of exposures in the form of private equity investments.

- The method described in Article 65 permits institutions to use the average risk weight of the investment's underlying exposures if certain conditions are met. The calculation may be performed by the institution itself or by a third party. When the institution relies on a third party to calculate the average risk-weighted exposure amounts, the third party should have sufficient competence and expertise to ensure that the calculation is accurate. In practice, the third party can be any entity that possesses sufficient information concerning the CIU, such as the fund manager or the securities custodian. When the institution performs the calculation, it should be based on the CIU's investment mandate, or any other information that is available on the composition of the CIU's portfolio (such as information provided directly by the CIU's manager) and that satisfies the conditions for using the investment mandate.

Exposures relating to finance lease agreements and lease agreements of a financial nature

137 Under Article 71 of the Order of 20 February 2007 (amended), "the exposure value of finance lease agreements and lease agreements of a financial nature can be decomposed into two elements: the discounted value of minimum lease payments, and, where applicable, a fraction of the residual value at risk equal to 1/t, where t is equal to the greater of 1 and the number of years remaining in the term of the agreement. These two elements shall be assigned different risk weights, with the discounted value of the residual value being treated as a tangible asset".

3.1.2.2. Calculation of risk parameters

138 The minimum observation periods to be used in quantifying the various risk parameters are defined in the regulation. The length of the historical observation period depends on the approach used, and may be reduced when one of the IRB approaches is first adopted. The minimum observation periods are summarised in Annex E of this Notice.

Definition of default

- Treatment of overdrafts: once any one of the three criteria set forth in the first paragraph of Article 118-2 is fulfilled, or one of the situations to which they correspond is clearly present, the institution should count the exposure as past due, assuming the criteria can be applied to the exposure in question. The second paragraph of Article 118-2, which presents an alternative to the first paragraph, permits institutions that perform "rigorous daily monitoring of overdrafts and have a documented procedure" to apply a single criterion: the request for repayment.
- Treatment of exposures covered by debt reduction plans: the treatment of such loans depends on their status:
  - for files for which a debt reduction plan has been accepted, the exposure is no longer treated as in default from the date the plan is accepted, or, at the latest, the date that regular payments are resumed (the institution should base its choice on its information system). In the event of a new past-due payment, the file should be returned to default status, but it should be restored to healthy status once the past-due amount has been settled;

- debt reduction plans covered by a moratorium remain in default status;

- for debt reduction plans covered by a quasi-moratorium, the decision to remove or maintain the file in default status is left to the judgement of the institution, on condition that its procedures are documented and that its choice is based on significance criteria and statistical data.

Calculation of LGD

139 Institutions can refer to the “Guidelines on the Implementation, Validation and Assessment of Advanced Measurement (AMA) and Internal Ratings Based (IRB) Approaches” published by EBA/CEBS on 4 April 2006, and to the “Guidance on the Estimation of Loss Given Default (Paragraph 468 of the Framework Document)” published by the Basel Committee in July 2005, for information on the methods for calculating LGD, and in particular for guidance on reflecting the impact of economic downturns and on the discount rate to be used. These documents state that a discount rate equal to the sum of the risk-free rate and an appropriate spread may be used, or alternatively, subject to certain conditions, the effective interest rate (not the nominal rate) at origination of the loans as defined in IAS 39. The appropriateness of LGD estimates can only be judged in the light of the discount rate used.

140 For the calculation of the LGD in the Advanced IRB approach, guarantees must comply with the requirements set forth for the calculation of the LGD, notably those provided in Article 127 of the Order of 20 February 2007 (amended). In particular, minimal requirements relating to credit risk mitigation set forth in Title IV of the Order of 20 February 2007 (amended) must be satisfied. The effective LGD calculated in the Foundation IRB approach, under Article 179 of the Order of 20 February 2007 (amended), can be equal to zero. This will be the case when the conditions set forth in Article 127 are satisfied, there is no currency mismatch, and a volatility adjustment of 0% is applied to the cash collateral.

Calculation of exposure value

141 In the Foundation IRB approach, institutions should apply the regulatory credit conversion factors specified for the Standardised approach (see Article 78) to their off-balance-sheet items, except for the items specifically mentioned in Article 76.

142 In the Advanced IRB approach, institutions estimate credit conversion factors for all off-balance-sheet items, except high-risk items (to which a credit conversion factor of 100% applies). When an institution is unable to estimate credit conversion factors, for example because of the specificity of the product in question, the use of regulatory credit conversion factors may be authorised. Such exemptions should be considered during the authorisation process.

143 The historical data of credit conversion factors for the modelling of the EAD must be five-year-long at the date of the validation by the ACP. One supplementary year might be required, depending on the method used by the subject institution and by the one used by other institutions for the calculation of other risk parameters (PD, LGD). In the case of the extraction from the database of one year of data in order to back test the model, instead of isolating from the database one sample for calibration and one sample for validation, one supplementary year is considered necessary for the purpose of the validation.

144 In general, credit derivatives of all types (credit default swaps, total return swaps, Nth-to-default derivatives, etc.) are treated as high-risk off-balance-sheet items (100% credit conversion factor) in accordance with Annex I of the Order of 20 February 2007 (amended).

Calculation of maturity (M)

145 The formula for calculating maturity (M) in Article 89-1 is to be applied to instruments that have a predetermined cash flow schedule. This formula should not be used when it is necessary to make assumptions regarding future cash flows. For variable-rate instruments (loans or securities), the provisions of Article 89-1(e) should be applied (the maturity is set equal to the maximum remaining number of years that the obligor is permitted to take to fully discharge its contractual obligations), resulting in a conservative measure of maturity. Interest rate swaps, whose cash flows are undefined by definition, should be treated in this fashion.

3.1.2.3. Treatment of defaulted assets

146 In the Advanced IRB approach, capital requirements for defaulted assets are defined as the difference between the LGD of the defaulted assets and the best estimate of expected loss (EL_{BE}), when that difference is positive. This difference should normally be calculated line by line. However, for the retail portfolio, the calculation may be based on the average values for pools of defaulted assets rather than at the level of each individual defaulted exposure. The best estimate of expected loss may be approximated by the specific provisions booked for the exposure, provided that institutions include material collection costs when estimating these provisions, and also recognise, when estimating collection flows, the uncertainty that a prospective economic slowdown creates for the collection amount and period.

3.1.3. Credit Risk mitigation techniques

147 The notion of 'main index', defined in Article 160(d) as "a broadly diversified index composed of sufficiently diversified securities", is used several times in Title IV. Institutions are responsible for determining which indices satisfy that definition, and they should be able to justify that determination. As a starting point, institutions can refer to Annex F1 of this Notice (list of securities considered sufficiently liquid) and Annex F2 of this Notice (list of indices considered broadly diversified), with the understanding that they should be able to justify any additions to these lists

148 In general, in order to be considered eligible, credit protection may not be positively and significantly correlated with the items covered (see Article 167-1 for financial collateral and Article 192-4(j) for guarantees). The regulation does not impose any particular method for measuring the correlation between the protection and the item covered. In particular, no quantitative threshold (maximum acceptable correlation) has been set. Institutions should be able to demonstrate to the ACP that they have taken the steps necessary to satisfy this requirement. The steps taken, as part of the risk management process, can be quantitative or qualitative; their principal objective being to ensure that the credit protection is real by avoiding the risk that the value of the credit protection reflected in the calculation of risk-weighted exposures can be realised in the event that the covered exposure defaults.

149 Unless provided otherwise, credit risk mitigation techniques are to be taken into account before applying credit conversion factors to off-balance-sheet items.

150 The implicit State guarantee for too-big-to-fail actors cannot be taken into account by subject institutions to mitigate their PD or LGD. Nevertheless, credit institutions can consider the sector of activity of their counterparty as an element among others to assess counterparty rating (PD) and, to a lesser extent, transaction rating (LGD). This recognition must then be rigorously justified and documented.

3.1.3.1. Treatment of collateral

151 The exemption provided in Articles 166-2 and 184-2 is not an individual exemption that the ACP will apply on a case by case basis as a function of the circumstances of specific institutions. It is a general exemption relating to conditions in the real estate market which, when granted, will apply to all institutions that satisfy the conditions relating to loss rates. This exemption is identical to the exemption in the Standardised approach, which is detailed in paragraph 97.

152 Currency mismatches are not taken into account when the Financial Collateral Simple method is used: the risk weight that applies to the collateral is simply substituted for the risk weight of the covered portion of the initial exposure, with a minimum risk weight of 20%. It should be noted that one of the conditions for being exempted from that 20% floor is the absence of a currency mismatch.

153 For institutions using the Foundation IRB approach, the treatment of collateral depends on their nature:

– eligible financial collateral is treated by applying the Financial Collateral Comprehensive method (set forth in Articles 177 *et seq.*), which involves calculating a fully adjusted exposure value (E*) that is then used to compute an adjusted LGD (LGD*, see Article 185). The effects of eligible financial collateral are thus reflected indirectly in the value of LGD

– eligible guarantees are reflected directly in the value of LGD using an LGD substitution mechanism (see Article 184-1). Volatility adjustments for currency mismatches (defined in the Comprehensive method) do not apply in this context.

154 For the recognition of financial collateral (detailed in Articles 174 *et seq.* of the Order of 20 February 2007 (amended)), an exception to the general rule of prohibiting the simultaneous application of the Simplified method and the Comprehensive method is provided for the cases mentioned in Articles 39-2 and 44-1 of the Order of 20 February 2007 (amended).

3.1.3.2. Treatment of guarantees and credit derivatives

155 The recognition of guarantees and credit derivatives is predicated on satisfying the minimum requirements, which apply to the protection provider and the protection itself. That is, both the protection and the protection provider must satisfy the eligibility criteria in order for protection to be taken into account.

156 Insurance companies and other corporate entities (see Article 186(g)) may be recognised as protection providers provided the minimum requirements are satisfied, including the requirement for an adequate external credit assessment (or internal rating).

157 The conditions for considering protection providers eligible for the double default adjustment set forth in Article 188 are designed to take changes in the provider's credit quality into account, avoiding excessive threshold effects. Thus:

- if the protection provider has an internal rating associated with a default probability that corresponds to credit quality step 2 or higher at the time that the protection is put in place, then the provider remains eligible even if its rating deteriorates by one step (to a rating associated with credit quality step 3);
- if the protection provider has an internal rating associated with a default probability that corresponds to credit quality step 3 or higher at the time that the protection is put in place, then the provider becomes eligible if its rating improves by one step (to a rating associated with credit quality step 2);
- in all cases, if the protection provider has an internal rating associated with a default probability that corresponds to a credit quality step lower than 3, it is not eligible.

3.1.3.3. Netting and novation mechanisms

158 Institutions are responsible for ensuring that master novation agreements and master netting agreements that they recognise in calculating risk-weighted exposures satisfy the regulatory requirements set forth in Article 200. Institutions should be able to show that master novation agreements and master netting agreements satisfy the minimum requirements.

159 The effects of master novation agreements and master netting agreements are not recognised in the Financial Collateral Simple method set forth in Articles 174 *et seq*. Since an institution cannot use both the Simple method and the Comprehensive method at the same time, an institution wishing to recognise the effects of a master novation agreement or a master netting agreement may not use the Simple method for any of its exposures.

160 Balance sheet netting results in treating deposits like cash collateral. Institutions using the Standardised approach for credit risk can therefore use either the Financial Collateral Simple method (Articles 174 *et seq*.) or the Financial Collateral Comprehensive method (Articles 177 *et seq*.). Institutions using the Foundation IRB approach must use the Financial Collateral Comprehensive method: the fully-adjusted exposure value (E*) which is calculated is used to adjust LGD and determine the value of LGD* which is used to calculate risk-weighted exposures.

3.1.3.4. Maturity mismatches

161 The maturity of protection is the time remaining until the earliest date on which the protection is likely no longer to be usable (see Article 206). In determining the maturity of units in collective investment undertakings, the calculation should be based not on the maturity of the investments made by the undertaking, but on the maturity of the units.

3.1.4. Securitisation

3.1.4.1. Clarification on the prudential definition of securitisation

162 Article 4-1(m) of the Order of 20 February 2007 (amended) gives the prudential definition of securitisation. It states that credit risk must be subdivided into at least two tranches for the transaction or structure to be treated as a securitisation from a prudential perspective. In particular, a securitisation fund (Fonds Commun de Titrisation, as defined by Article L214-49-4 of the Monetary and Financial Code) or equivalent vehicle that has issued only one category of units, with no

subordination arrangements, should not be counted as a securitisation from a prudential perspective and should be treated as a CIU.

3.1.4.2. Assessing the significance of credit risk transfer

163 Articles 218 and 219 of the Order of 20 February 2007 (amended) specify the minimum requirements for recognising a significant transfer of credit risk.

164 Without prejudice to the outcome of international work on this subject, the following approach shall be used for the application of Articles 218 and 219, which provide that a "significant fraction of the credit risk associated with the securitised exposures" must be transferred in order for the rules relating to securitisation to be applied.

165 The ACP reserves the right to judge whether the ultimate reduction in risk-weighted assets that an originating subject institution obtains through a securitisation is or is not justified by a proportional transfer of risk to third parties. In particular, the significance of the transfer may be measured by comparing the risk-weighted exposure amounts of the tranches retained after securitisation with the risk-weighted exposure amounts before securitisation. The transfer is considered to be significant if the reduction in the risk-weighted exposure amount is at least 10% (i.e., a ceiling of 90% is applied to the retention of risk).

166 In any case, the 90% ceiling on retained risk-weighted exposures applies to the entire set of transactions in process that were entered into before 31 December 2010.

167 The ratio of the reduction in risk-weighted assets is calculated without risks taken on the protection seller (excluding counterparty risk for unfunded protection and excluding the impact of mismatches). However, in accordance with the statement issued by the Basel Committee in December 2011[20] on the treatment of high cost credit protection, when calculating the ratio of the reduction in risk-weighted assets, account should be taken of the cost of protection that has not yet been recognised in earnings. Accordingly, the entire cost of protection should be estimated, that is, the discounted value of the cost should be calculated over the entire life of the transaction, and all material transaction costs should be recognised, not only the premium. Where justified, the discounted value of income from protected assets may be deducted from the total cost of protection.

168 The criteria for assessing the significance of risk transfers should be satisfied on a continuous basis. Consequently, institutions must establish an appropriate system of monitoring and periodic review.

The assessment of the significance of risk transfer may eventually be based on the internal models used by the institutions to take into account the effects of the securitisation on their risks. The application of the rules relating to securitisations will then be conditioned on there being a greater risk reduction in economic capital than in regulatory capital. Institutions wishing to do so will be able to substitute this approach for the quantitative threshold described above, subject to prior approval.

169 In operations that restructure tranches corresponding to one or more positions in a securitisation (for example, 'reconfiguration' structures), a significant new risk transfer at the level of the restructured tranche must take place. This requirement shall apply at least to all transactions entered into on or after 1 January 2011. Furthermore, given the uncertainties in evaluating underlyings in this type of transaction, rating from two agencies (preferably at least one of which rated the initial tranches) is also required. Finally, the risk weights defined in the new framework for resecuritisation have

[20] Available on the website of the Basel Committee: http://www.bis.org/publ/bcbs_nl16.htm

applied to these restructuring operations (including current securitisation structures) since the CRD3 directive come to effect on 31 December 2011.

170 In addition to the automatic test, the economic assessment of the significance of risk transfer will be based on the following criteria:

- Has the risk been transferred by a mechanism such that losses are effectively borne by a third party, and does that party have the capacity to absorb them?
- Has the risk been transferred by the originating institution at a cost that essentially cancels out the value of the protection?
- Are there mechanisms, such as rebates or guarantees, that amount to reimbursing the third party to which the risk is transferred for the losses that the third party may be required to absorb?
- Does the transaction contain any unusual clauses meaning that losses are unlikely to be effectively assigned to a third party?
- Is there a risk that the bank might provide support for the third party to which the risk has been transferred (ownership or business ties, implicit support)?

171 As provided in Article 216 of the 20 February 2007 Order (amended), overlaps between securitisation positions of the banking and trading books may exist. This happens when an institution originating a securitisation transaction issues a securitisation tranche, covered by a liquidity or credit line, which it then buys back and books in the trading book. This leads to an overlap between capital requirements for the specific risk relating to trading book provisions and the capital requirements specific to credit risks relating to banking book positions.

3.1.4.3. Due diligence, in particular concerning the retention threshold

172 The criteria for granting loans that originating or sponsoring credit institutions apply to the exposures to be securitised should be equivalent to those that they apply to exposures whose risks they retain, as provided in Article 217-1 of the Order of 20 February 2007 (amended). Investors in securitisation positions should possess a thorough understanding of the risk to which they are exposed. They should conduct appropriate due diligence, as provided in Article 217-1 of the Order. The failure of an investor to satisfy these due diligence obligations shall result in an additional capital charge, whose application is described in the EBA Guidelines published on 31 December 2010 on the application of Article 122a of European Directive 2006/48/EC as amended by European Directive 209/111/EC. Further, in order to align the interests of originators and sponsors more closely with those of investors, originators or sponsors must retain at least 5% of the economic interest of the securitisations that they put in place. In application of Article 217-1 of the Order of 20 February 2007 (amended), investors should ensure that originators or sponsors satisfy this retention threshold according to one of the four methods described in Article 217-1(a). These methods are described more fully in the EBA Guidelines of 31 December 2010, which the ACP considers to be a reference that institutions should apply. The EBA Guidelines also outline the procedures for applying additional capital charges to investors in the event of non-compliance. The EBA has published answers to the most frequently asked questions on applying the Guidelines. Compliance with the provisions set out in Article 217-1(e) of the Order of 20 February 2007 (amended) shall be assessed at least annually, but a credit institution must also review compliance if there is a material change in the performance of securitisation positions or underlying exposures, or if an event occurs that has a material impact on the securitisation transaction (for example, if a contractual trigger is breached, or if the originator, sponsor or original lender becomes insolvent).

Originator, sponsor or original lender

173 If the sponsor of a securitisation transaction is not a credit institution, the requirements of Article 217-1 of the Order of 20 February 2007 (amended) must be met either by the original lender or by the originator. If, in the case of a given transaction, it is impossible to clearly identify which party is acting as originator, sponsor, or original lender, it is necessary first to verify that the transaction

meets the prudential definition of securitisation, and then, where applicable, that compliance with Article 217-1 of the Order of 20 February 2007 (amended) is ensured by whichever party most appropriately fulfils this role. The interests of investors should be aligned with those of that party that is transferring a proportion of the risks and rewards of the underlying exposures to an investor.

174 Net economic interest must be maintained on an ongoing basis and must not be subject to any sale or hedge. However, the retention requirement is not considered to be reduced by amortisation via cash flow allocation or through the allocation of losses, which naturally reduce the level of retention over the life of the transaction. In no circumstances should the securitisation transaction be structured such that the retention of the originator, sponsor or original lender declines faster over time than the transferred interest. In the case of a securitisation transaction involving multiple originators or original lenders, compliance with the retention threshold shall be on a proportional basis for each originator or original lender, or alternatively, by the sponsor of the transaction, which pools the exposures to carry out the transaction. In other words, fulfilling the retention requirement is never undertaken by one party at the expense of all the others. In a case where multiple originators or original lenders included in the same scope of prudential supervision on a consolidated basis within the meaning of Regulation 2000-03 are involved in the same transaction, the retention requirement shall be met by one of the entities in the group, so that retention can be met at the consolidated level. When investing in a securitisation position, the investing institution must ensure that the originator, sponsor or original lender has "expressly disclosed" that it will fulfil its retention obligation. The investor cannot be held responsible if the originator, sponsor or original lender fails to act in the manner it disclosed.

Net economic interest and retention options

175 The retention threshold is set at 5% at least of the nominal value of securitised exposures: this refers to the gross exposure value, i.e. gross of impairments and value adjustments. The retention requirement may be fulfilled by any one of options (i), (ii), (iii) or (iv) of Article 217-1(a) of the Order of 20 February 2007 (amended), but not by a combination of these options. Similarly, the retention requirement can be fulfilled by the originator, the sponsor or the original lender, but not by a combination of the three. The retention method used must be explicitly described.

The Order of 20 February 2007 (amended) stipulates in Article 217-1 that "retained positions, interest or exposures are not hedged or sold". Accordingly, to maintain significant net economic interest on an ongoing basis, institutions must not sell or hedge retained positions. However, institutions acting as originator, sponsor or original lender keep some flexibility to be able to appropriately manage their credit risk.

176 The abovementioned EBA Guidelines of 31 December 2010 provide examples of the procedures that may be followed to comply with the criteria for each of options (i) to (iv). Thus:

- Option (i): "Vertical slice" retention of at least 5% of the nominal value of each of the tranches sold or transferred to investors may also be achieved by retaining at least 5% of the credit risk of each of the underlying securitised exposures, if the credit risk thus retained with respect to such securitised exposures ranks pari passu with, or is subordinated to, the credit risk that has been securitised.

- Option (ii): When liquidity facilities are provided to Asset Backed Commercial Paper (ABCP) programmes, the retention requirement may be met under option (ii) in the following circumstances: the facility covers the credit risk of the exposures, and not just the risk of a temporary liquidity shortage in the event of market disruption, and the capital requirement for such facility is calculated accordingly; the facility covers 100% of the credit risk of such exposures; the terms of such facility must ensure that it remains available for as long as the originator, sponsor or original lender has to meet the retention requirement by means of such facility; the facility is provided by the originator, sponsor or original lender (and not by any other entity); the investor has sufficient access to appropriate documentation to enable it to verify compliance with the above points.

- Option (iii): During the process of randomly selecting exposures, credit institutions should consider both quantitative and qualitative factors (the Guidelines provide a list of factors that may be used) when defining the pool of potentially securitised exposures from which the exposures retained and the exposures securitised are drawn, and consequently only truly "random" differences should exist or evolve between the retained and securitised exposures. The requirement that the number of potentially securitised exposures is no less than 100 at origination means that the pool of potentially securitised exposures from which the 5% of randomly selected exposures is drawn contains no fewer than 100 exposures, not that the randomly selected retained exposures themselves consist of no fewer than 100 exposures. As a general principle, the choice of option (iii), which is preferred for granular pools of securitised exposures, should not result in either the retained or securitised portion being overly concentrated. The requirement to retain "randomly selected exposures, equivalent to no less than 5% of the nominal amount of the securitised exposures, where such exposures would otherwise have been securitised in the securitisation" means that the retained exposures are calculated as 5.0% (5/100), not as 4.76% (5/105). Under option (iii), the randomly selected exposures retained to meet the requirement should be a static pool of exposures and fixed over time, except in the case of revolving exposures, with replenishment being subject to the guidance on randomness provided above.

- Option (iv): A "first loss tranche" may consist of such exposures as a subordinated note, a reserve account, an equity interest, a preference share interest, or a deferred purchase price element. This is a non-exhaustive list. A "first loss tranche" may also be created on a synthetic or derivative basis (for instance, a total return swap or letter of credit). Retention of a "first loss" tranche may also be achieved by comparable means, for instance by overcollateralising the liabilities of a securitisation. A letter of credit, guarantee or similar form of credit support may also be a permissible form of retention under this option (iv), provided that: this support covers the credit risk of the exposures; it covers at least 5% of the credit risk of such exposures and assumes a first-loss position with respect to the securitisation; it covers such credit risk for as long as the originator, sponsor or original lender has to meet the retention requirement by means of this support; it is provided by the originator, sponsor or original lender and not by any other entity; and the investor has sufficient access to appropriate documentation to enable it to verify compliance with the above points. To give one example, it is possible that stand-by letters of credit, provided as program-wide credit enhancement to ABCP conduits by the conduit sponsor, might be able to fulfil the retention requirement under option (iv), assuming that they meet the requirements outlined above. Funded reserve accounts (or the funded portion of a reserve account, if partially funded) may fulfil the retention requirement provided they have the capacity to absorb losses on the underlying exposures. If receivables are sold by the seller at a discount, the difference between the discount and the selling price may under certain conditions be treated as a first loss tranche. In certain securitisations (such as those of ABCP conduits), the retention requirement could be fulfilled if the originator, sponsor or original lender has retained a 5% net economic interest in the underlying securitised exposures, including by way of sale of the exposures at a discount of 5%.

177 Measurement of material net economic interest provided for in Article 217-1(a) of the Order of 20 February 2007 (amended):

The retention requirement, as applied under option (i), references the "tranches" of the securitisation; the retention requirement, as applied under options (ii), (iii) and (iv), references the "securitised exposures" (or potentially securitised exposures). It is recognised that under certain circumstances this could lead to different outcomes between the different options when measuring the retention requirement (for instance, if the securitisation benefits from overcollateralisation, i.e. the value of securitised exposures is higher than the nominal value of tranches issued under such securitisation).

178 It is possible that retention may be met in a manner that can be equated to one of options (i) through (iv) in Article 217-1(a) of the Order of 20 February 2007 (amended), but that takes a synthetic or contingent approach, or that uses derivatives.

179 Multiple application of the retention requirement: Article 217-1(a) of the Order of 20 February 2007 (amended) states that there shall be no multiple applications of the retention requirement. This does not mean that there is a prohibition on multiple applications; rather that it suffices that for any given securitisation only one of the originator, sponsor or original lender is subject to the requirement. For a resecuritisation, the investor need only check fulfilment of the retention requirement for the second layer of the transaction, and not the first underlying layer of the transaction. In the case of resecuritisations, there may be instances of multiple retention, notably at the overall transaction level (i.e. taking into account the first and second securitisation transactions). Conversely, if the presence of several SPVs in a transaction is the result of the transaction's overall legal structure, retention is not necessarily fulfilled at the level of each vehicle but instances of multiple retention may nevertheless occur. However, both in the context of resecuritisations and more generally, investors should be particularly sensitive to the use of intermediating SPVs, and should ensure that the transaction is not structured so as to void Article 217-1 of the Order of 20 February 2007 (amended) of its substance. When an institution acts as investor in a resecuritisation transaction, it is not required to ensure that retention is also met at the level of the first securitisation transaction underlying the resecuritisation.

180 The minimum required retention level is 5%, but there is nothing to prevent institutions acting as originator, sponsor or original lender from retaining a higher percentage of net economic interest in the transaction.

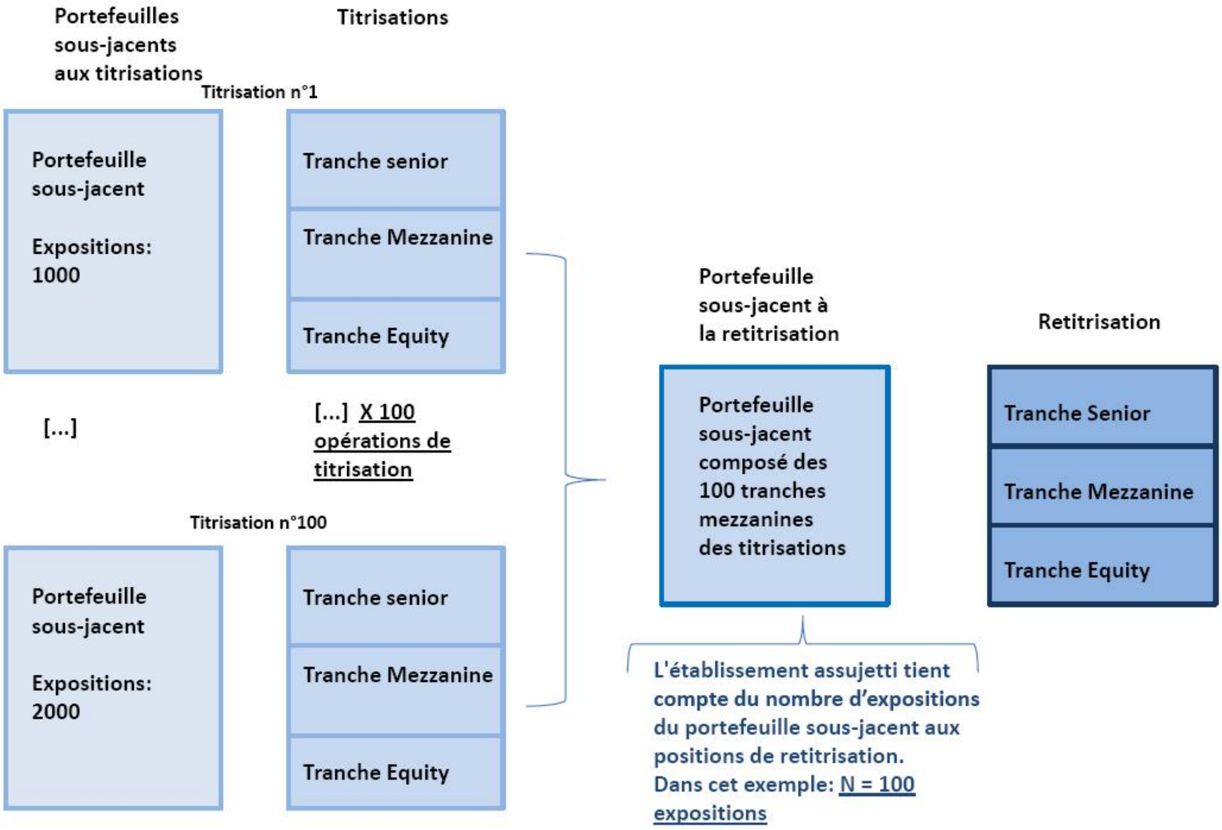
181 When the retention requirement is fulfilled by the originator, sponsor or original lender using any of options (i) through (iv), the retained portion may be used by the sponsor, originator or original lender as collateral for loans or in securities financing transactions under a standard contract (such as ISDA), as long as the credit risk of these exposures is not transferred.

182 In accordance with Article 215 of the Order of 20 February 2007 (amended), the provider of credit protection to securitisation positions is considered to hold positions in the securitisation, and is, therefore, subject to Article 217-1 of the Order of 20 February 2007 (amended) in the same manner as an investor.

3.1.4.4. Calculation rules

183 The term 'retail exposures' used in Article 233 refers to the definition of the exposure class of the same name.

184 Article 244 gives details about the parameters to use in the supervisory formula. Regarding parameter N (effective number of securitised exposures), in the case of resecuritisations, institutions should take into account the number of exposures of the portfolio underlying resecuritisation positions, not of the portfolio underlying securitisation positions, as explained in the following diagram:



3.1.4.5. Use of ratings from external credit assessment institutions

185 The tables for mapping between the credit quality steps cited in Articles 222 and 242-1 and the credit assessments produced by external credit assessment institutions recognised by the ACP are provided in the Annex C of this Notice.

186 Based on work by the Financial Stability Board (*http://www.financialstabilityboard.org/publications/r_101027.pdf*), the SGACP recommends an intelligent (i.e. non automatic) use of external ratings. Article 255(c) of the Order of 20 February 2007 (amended) is based on the principle that no prudential recognition is granted to an institution that provides itself with protection or ensures the liquidity of its own positions (both are self-supports). Thus, Article 255(c) of the Order indicates that an external rating reflecting such a support should not be included in capital requirements calculations. This article also indicates that for the calculation of risk-weighted amounts, the external credit rating cannot be based, in whole or in part, on the unfunded self-support of the institution. If an external rating takes into account such a support, the institution should estimate a risk weight based on the actual risk and not take into account the self protection, as stated in Recital 31 of Directive 2010/76/EU (CRD3). For instance, the institution could take into account the external rating given before or without the unfunded support. If the institution cannot do this, it deducts securitisation exposures from its capital.

3.1.5. Dilution risk

187 Institutions may use a broad definition of dilution risk, such that the capital requirements for the risk of loss associated with the acquisition of false receivables are assessed as a credit risk – based on the probability of default of the factor's customer – and not as an operational risk.

3.1.6. Counterparty credit risk

188 The Standardised method set forth in Chapter IV of Title VI does not provide a specific treatment for Nth-to-default credit derivatives, and the rules for single-name credit derivatives do not provide a basis for determining the treatment that should apply. The CRD Transposition Group considers that the following treatment – which is consistent with the methodology of the Standardised approach and is derived from the general treatment of debt instruments – can be applied:

– the size of the risk position associated with a reference debt instrument in the basket of exposures that underlies an Nth-to-default credit derivative is equal to the effective notional value of the reference instrument, multiplied by the delta equivalent of the value of the Nth-to-default credit derivative measured in terms of a change in the credit spread of the reference instrument;

– there is a hedging set for each reference instrument in the basket of exposures that underlies the Nth-to-default credit derivative. The risk positions of different Nth-to-default credit derivatives should not be included in the same hedging set;

– the multiplier that applies to the different hedging sets created by the reference instruments of an Nth-to-default credit derivative is 0.3% for investment-grade debt instruments and 0.6% for non-investment-grade debt instruments.

3.2. Market risk

3.2.1. Rules relative to the assets valued at fair value through profit or loss

189 The provisions of the Order of 20 February 2007 as amended by the Order of 23 November 2011 apply to all instruments valued at fair value, whether they belong or nor to the trading book of the institution. If the application of prudent valuation rules provides a lower value than the value booked in the accounts, the institution should deduct from its capital the absolute value between both values.

3.2.2. Definition of the trading book

190 The trading book, which serves as reference for the calculation of market risk, has a prudential definition (Article 298 *et seq*.), that is independent of accounting definitions. However, in accordance with Articles 302 (for subject institutions that are not subject to IFRS standards) and 303 (for subject institutions that are subject to IFRS standards), current accounting definitions should serve as a reference and a starting point for the prudential definition of the trading book, with marginal adjustments possible, as provided in Article 302, subject to prior communication to the SGACP, which may prohibit the adjustments

191 In accordance with the definition of the trading book and the management rules that apply to it (see Chapter 2 of Title VI), items in the trading book should be clearly marketable, as reflected in their liquidity or in actual trading activity; and their holding period should correspond to short-term trading intent. For subject institutions that are subject to IFRS standards, the following items do not satisfy the conditions for inclusion in the trading book:

– instruments for hedging the interest risk of securities held in the investment portfolio (‘*portefeuille d’investissement*’ under French accounting standards) on the solo balance sheet, and classified as held to maturity (‘*portefeuille détenus jusqu’à leur échéance*’ under IFRS accounting standards) on the consolidated balance sheet;

– credit derivatives held for trading purposes on the consolidated balance sheet, which hedge banking-book items that are not held with trading intent.

3.2.3. Determination of the net position

192 Securitisation positions held in the trading book are treated as debt instruments held in the trading book for the calculation of capital charges for market risk

193 In keeping with the treatment of basket credit derivatives held in the banking book (see Article 196), the following treatment applies to basket credit derivatives held in the trading book.

- First-to-default credit derivatives: when an institution obtains credit protection for a basket of exposures in the form of a first-to-default credit derivative, it may offset the specific risk of the underlying asset with the smallest percentage of specific risk. This treatment applies only if the first default triggers payment and terminates the contract
- Nth-to-default credit derivatives: when payment is triggered by the Nth default, the protection buyer may offset the specific risk (as provided for first-to-default credit derivatives) only if the protection buyer has already obtained protection for defaults 1 to N-1 or unless N-1 defaults have already occurred.

194 For the calculation of capital requirements for general risk, the net position on an index that cannot be decomposed on a single national market must be offset at the index level and thus be subject to a separate calculation. The 8% ratio is then applied to the net position on this index.

195 The reasoning is the same for the calculation of capital requirements for optional risk, notably within the delta plus method, for the net position on an index that cannot be decomposed on a single national market.

3.2.4. Positions related to credit derivatives

196 The definition of the capital requirement calculations base related to market risk resulting from credit derivatives positions is as follows:

- as far as the institution selling the protection is concerned, Article 315 allows the institution to define the base as the notional amount of the credit derivative or the algebraic sum of the notional amount and market value of the credit derivative;

- for the institution buying the protection, the base is defined as the notional amount of the credit derivative or the difference between the notional amount and the market value of the credit derivative. In compliance with Article 316, the buyer's position is determined symmetrically vis-à-vis the seller's position.

3.2.5. Capital requirements related to specific risks in the framework of interest rate risk

197 For all the positions subject to interest rate risk, the own funds requirements resulting from the base could be capped by the maximum loss stemming from a default. In the case of a credit derivatives position, as far as the protection seller is concerned, the maximum loss is equal to the base taken into account and, as far as the protection buyer is concerned, the institution should deduct the present value of all the spreads still to pay from the market value of the derivative.

3.2.6. Method and accounting of settlement/delivery risk

198 In compliance with Article 336, own funds requirements for settlement/delivery risk are calculated for operations booked in the trading book and also for operations related to the banking book. Institutions that take into account the settlement/delivery risk at the trade date should calculate own funds requirements between the trade date and the settlement date in compliance with Articles 336 to 337-4 of the 20 February 2007 Order (amended). Institutions that take into account the

settlement/delivery risk at the settlement date still apply the following rule: the amount is booked in adjustment accounts between the trade date and the settlement date and it is risk-weighted at 100% or as a function of the risk-weight applicable to the counterparty if it is identified.

3.2.7. Standardised Approach

199 Article 330-3 provides that no capital requirement is applied to stock-index futures which are traded on a recognised exchange and which represent broadly diversified indices. Institutions applying this article are responsible for determining which indices satisfy this definition, and they should be able to justify those determinations. The list of recognised exchanges is set and published by the Financial Markets Authority (Autorité des Marchés Financiers – AMF). The principal broadly diversified exchanges are listed in Annex F2 of this Notice. Institutions considering other indices to be broadly diversified should be able to justify that assumption to the ACP.

200 Institutions using the IRB approach for credit risk that use internal ratings in place of external credit assessments to implement Article 321 must be able to compare the obligor's probability of default with the implicit probabilities associated with credit quality steps. IRB institutions are not required to use internal ratings to implement Article 321; they may rely directly on external credit assessments.

3.2.8. Internal Model Approach

3.2.8.1. Authorisation to use internal models

201 Under Articles 292-3 and 344 of the Order of 20 February 2007 (amended), the ACP may authorise subject institutions to use internal models to calculate capital requirements for market risk in the trading book, foreign exchange risk and associated optional risk if these models adequately satisfy the requirements set out in Chapter VII of Title VII of the Order.

202 Modelling the specific risk associated with debt or equity securities with a derivative instrument based on such securities requires a separate authorisation from the ACP under Article 347-1 of the Order of 20 February 2007 (amended). Under Article 352, Part IV, in the event that an internal model is not used or in the event that the ACP does not recognise the model for the treatment of specific risk, the subject institution shall use the Standardised method.

203 Two special cases should be highlighted concerning the treatment of specific risk:

- Institutions are not required to include default and migration risks for debt instruments in specific VaR if they recognise them in the IRC (Article 347-1(j)).
- Securitisation positions or Nth-to-default credit derivatives whose capital requirements for market risk in the trading book (general and specific risk) are determined using the Standardised method may be excluded from specific VaR, with the exception of positions subject to Comprehensive Risk Measurement (CRM) (Article 341-1(k)).

These two cases do not exclude modelling the general risk associated with these positions.

204 Authorisation to use the IRC and CRM is based on the authorisation given to institutions to model specific risk in VaR and stressed VaR, and on compliance with the quantitative and qualitative criteria set out in Section 4 of Chapter VII of the Order of 20 February 2007 (amended). The ACP may authorise an institution to use VaR and stressed VaR but not to use the IRC and/or CRM, meaning that capital requirements for specific risk would have to be determined using the Standardised method.

3.2.8.2. Treatment of securitisation positions

205 If the ACP authorises it, VaR may be used to determine capital requirements for market risk in the trading book (Article 292-3).

Consequently, if the ACP authorises VaR to be used for this area, securitisation positions and Nth-to-default credit derivatives, whether or not they are included in the correlation trading portfolio (CTP), are included in VaR for the purpose of determining capital requirements for general risk.

Two cases have been identified as regards determining capital requirements for specific risk:

- Non-CTP positions: capital requirements for the specific risk of these positions should be calculated using the Standardised method. They may therefore be excluded from specific risk VaR under the exception provided in Article 341-1(k) of the Order.
- CTP positions: either they are the subject of an additional calculation of capital requirements using the CRM method and must then be included in specific VaR; or they are subject to a supplementary capital charge calculated using the Standardised method and may be excluded from the calculation of specific VaR.
- The following tables describes the different cases:

Positions	**General risk**	**Specific risk**	
		Additional charge	**Specific VaR/SVaR**
Non-CTP	General VaR/SVaR	Standard charge	Inclusion or exclusion
CTP		Standard charge	Inclusion or exclusion
		CRM	Mandatory inclusion

3.2.8.3. Calculating the CRM floor

206 The amount of capital requirement for the comprehensive risk measure cannot be lower than 8% of the global capital requirement that would be calculated in compliance with Article 321-1 Order of 20 February 2007 (amended).

The floor is calculated as follows:

- in compliance with the Standardised approach related to market risk for securitisation positions (such as defined at Article 323-1 of the 20 February 2007 Order (amended)), that can refer to securitisation in the Standardised or Advanced approach as it is applied to the banking book;
- in compliance with the classic Standardised approach (defined in Article 321 of the Order of 20 February 2007 (amended)).

In compliance with the Article 347-2-10 of the 20 February 2007 Order, the floor should be calculated at least once a week (it may be included in the 12-week average as it is indicated in the last sentence of paragraph II b) of Article 352).

3.2.8.4. EBA Guidelines on Stressed Value-at-Risk and the Incremental Default and Migration Risk Charge (IRC)

207 The Guidelines on Stressed Value At Risk (Stressed VaR) and the Incremental Default and Migration Risk Charge (IRC) concern institutions that use internal models to calculate capital requirements for market risk.

208 The Stressed VaR Guidelines set out best practices for the identification and annual review of the stressed period, calculation methodology and Stressed VaR use tests. The main provisions are as follows:

- Selection of the stressed period: the institution should identify a continuous 12-month period of significant financial stress relevant to its trading portfolio, based on formulaic or judgement-based approaches.

- Review of the stressed period: the stressed period should be reviewed at least annually, but may be reviewed more frequently if necessary. Any change to the stressed period should be communicated to the ACP before implementation. Moreover, institutions should ensure, on an ongoing basis, that the specified stressed period remains representative.

- Stressed VaR modelling: Stressed VaR methodology should be based as far as possible on the current VaR methodology, except where specific requirements apply. Since Stressed VaR relies on the calibration of parameters based on a historical period, proxies may be used in the case of new risk factors for which historical data is not available.

209 The IRC Guidelines specifies the scope of application of the charge (i.e. instruments included in the IRC), requirements regarding probabilities of default (PDs) and transition matrices used, simulation of migrations and defaults on the one-year capital horizon, best practices for P&L valuation in the event of migration or default (impact on market prices and computation of P&L), definition of liquidity horizons, validation of IRC models and their operational use. The main provisions are as follows:

- Individual modelling: institutions should define a hierarchy of sources of internal and external ratings and take account of the specific conditions set out in the Guidelines to determine the PDs and LGDs used in their IRC model.

- Modelling interdependence: institutions should take account of the best practices detailed in the Guidelines on modelling correlations between default and migration events, as well as portfolio concentration.

- Specification of a migration matrix: institutions should model the probability of migration from one rating to another based on historical data, using a minimum observation period of five years.

- Constant level of risk assumption over the one-year capital horizon: institutions should model the IRC by resetting positions at the end of each liquidity horizon, so as to ensure the same level of risk as at the start of the liquidity horizon, over the one-year capital horizon. Institutions may however opt for a second approach, which consists in calculating the IRC assuming that positions remain constant over the one-year capital horizon. The assumption chosen must be applied to all positions affected by the IRC.

- Modelling the effects of rating changes on price changes: institutions should follow best practices when modelling the effects of rating changes on price changes.

- Definition of liquidity horizons: institutions should define liquidity horizons at a product level rather than on an issuer level, take account of key criteria given in the Guidelines for determining the relevant liquidity horizon, and regularly review liquidity horizons.

- General matters: institutions should apply the Guidelines on IRC validation, documentation and use tests.

- Frequency of calculation: the IRC should be at least weekly.

3.2.9. Crisis scenarios

210 The expression "reverse crisis scenario" refers to scenarios in which the result is assumed and causes are deduced from the result. This exercise must lead to an estimation of the maximum stress resistance of an institution.

3.3. Operational risk

3.3.1. Definition of operational risk

211 The scope of operational risk (notably distinguishing events related to operational risk from events related to other risks), along with the components of the loss amount associated with an operational risk event, are specified in EBA's "Guidelines on the scope of operational risk and operational risk" (See EBA "Compendium of supplementary guidelines on implementation issues of operational risk", September 2009).

212 Strategic risk is specifically excluded from the definition of operational risk in Article 4-1(c). Consequently, losses arising from strategic risk are not intended to be included in databases on operational losses, nor modelled in the AMA model for determining capital requirements.

213 The environmental risks confronting a credit institution can constitute operational risks within the meaning of Article 4-1(c). Some events resulting from an environmental risk (such as natural disasters or legal risks) can directly affect the performance of specific business lines, or even the overall performance of the credit institution. Events that are identified as operational risk events and which are associated with an environmental risk may therefore be subject to capital requirements, calculated using one of the three methods specified in the Order of 20 February 2007 (amended).

214 Losses resulting from project management or planning deficiencies should be included in the operational loss database if they satisfy the definition of operational risk in Article 4-1(c). The loss should be due to an internal deficiency or failure, or to an external event such as fraud committed by the employees of a contractor providing services to the project. In all cases, the appropriate classification is to be found in the loss event itself. The category 'execution, delivery, and process management' will normally be the appropriate classification in most cases, while the category 'customers, products, and business practices' should be reserved for cases in which the institution fails to meet its obligations towards its own customers.

3.3.2. Calculation of the reference indicator

215 The calculation of the reference indicator in the Basic Indicator and the Standardised approaches requires the use of the past three annual observations, made at the end of each financial year.

– These calculation methods can result in an institution having to use data calculated under different accounting frameworks (due to transition to IFRS standards, for example). The use of different accounting frameworks in calculating operational risk is not considered problematic, since the reference indicator is an approximation of operational risk, and is not likely to vary much as a function of the accounting framework.

– When the financial statements of the subject institution have not yet been certified, an estimate of the reference indicator is used. The essential element is to use historical data when they are available.

– The regulation is silent on what should be done when fewer than three observations are available, or even none (as would be the case for a new institution). The general rules apply nevertheless; and, in particular, regardless of the volume of data available for calculating the reference indicator, the institution should include operational risk in its assessment of internal capital under Pillar 2 of the capital framework. (see Article 17a of Regulation 97-02 relating to internal control). Institutions less than three years old may use estimates based on business forecasts in the calculation, provided that historical data are used as soon as they become available.

– If an institution can demonstrate that, due to exceptional circumstances (an important sale for instance), the use of the past three annual observations of the reference indicator would lead to a significant overestimation of its operational risk, the SGACP can authorise the use of a different method for the calculation of the reference indicator. In the case of a sale, if the assets sold are excluded from the seller's scope of consolidation for the calculation of capital charges for operational risk, they must symmetrically be included in the buyer's one.

216 The reference indicator is defined as the arithmetic sum of the items listed in Article 358-1. The following table indicates the rules to be used in calculating the reference indicator from FINREP data.

Guide for calculating the reference indicator under the IAS/IFRS framework

Items listed in Article 358-1	Corresponding items in the FINREP table "Consolidated income statement"	Treatment in calculating the reference indicator
1. Interest receivable and similar income	Interest income	include
2. Interest payable and similar charges	Interest expenses	include
	Expenses on share capital repayable on demand	do not include
3. Income from securities	Dividend income	include
4. Commissions/fees receivable	Fee and commission income	include
5. Commissions/fees payable	Fee and commission expenses	include
6. Net profit or net loss on financial operations	Realised gains (losses) on financial assets & liabilities not measured at fair value through profit or loss, net	partial inclusion if in the trading book
	Gains (losses) on financial assets and liabilities held for trading, net	include
	Gains (losses) on financial assets and liabilities designated at fair value through profit or loss, net	partial inclusion if in the trading book
	Gains (losses) from hedge accounting, net	include
	Exchange differences (net)	include
7. Other operating income	Other operating income	include – but additional adjustments may be needed to ensure that the items included do not exceed what is permitted in the regulation (see below)

217 As a general guide, the following items may be included in 'other operating income' in the IAS/IFRS framework: rental income from investment property (IAS 40.75) and rental income from operating leases (IAS 17.50). When including 'other operating income', credit institutions should

comply with the provisions of Articles 358-2 and 358-3 and ensure that the items included do not go beyond those limits. For these reasons, revenues generated by tangible assets which are quantified using revaluation or fair value models (IAS 16.39 and IAS 40.76) should not be included in 'other operating income' for the purpose of calculating the reference indicator for operational risk.

218 Under Article 358-3, items that are not involved in the ordinary business of the institution are excluded from the calculation of the reference indicator, so that the indicator will better reflect the activities of the institution. Connected activities such as insurance brokerage are part of the normal business of an institution and should be included in the calculation of the indicator (the commissions received by an external insurance broker should be included in the calculation of the reference indicator as 'fee and commission income' if they do not represent 'insurance income'). On a consolidated basis, when insurance business is conducted by other legal entities within a group, the insurance premiums should not be included in the reference indicator. This treatment is consistent with the fact that insurance is not one of the business lines identified in Annex IV of the Order of 20 February 2007 (amended).

3.3.3. Standardised approach

219 All of the activities contributing to the composition of the reference indicator should be included in the calculation of capital requirements for operational risk. Activities that are not specifically mentioned should be assigned to the category corresponding to (or most closely to) their business line. If an activity cannot be assigned to a specific business line, the business line that represents the largest percentage should be used.

220 The reference indicator should be calculated separately for each of the eight business lines. The principles guiding the mapping between activities and business lines are set forth in Section 3 of Chapter III of Title VIII. Under these principles, an institution could classify the revenues generated by leasing and factoring in either the 'commercial banking' or 'retail banking' categories, according to the type of obligor; and the gross revenues derived from debt collection activities (which represent simply a provision of services and not a loan to customers) would normally be assigned to either the 'commercial banking' or 'retail banking' business lines, since this type of activity is generally considered as a support function for these business lines.

221 In principle, an institution's connected activities (such as insurance brokerage) are included in the reference indicator. The assignment to an appropriate business line depends on the type of customer. If the transaction is with a customer belonging to the retail exposure class, as defined in Article 18 or Article 41, the corresponding revenue should be included in the 'retail banking' category. If not, it should be included in the 'commercial banking' category.

222 According to Annex IV of the Order of 20 February 2007 (amended), 'retail brokerage' includes "activities with physical persons or small- and medium-sized entities satisfying the eligibility criteria set out in Article 18". While the definition of retail exposures in Article 18 relates primarily to credit risk, institutions may nevertheless use it as the basis for their criteria for mapping activities to regulatory business lines in the context of operational risk, in accordance with Articles 361-1 and 362-2.

3.3.4. Advanced Measurement Approach (AMA)

223 In order to be authorised by the ACP to use the Advanced Measurement Approach, institutions must satisfy the minimum requirements (both qualitative and quantitative) set forth in Title VIII of the Order of 20 February 2007 (amended). For more detailed information on these requirements,

institutions can refer to the "Guidelines on the implementation, validation and assessment of Advanced Measurement (AMA) and Internal Ratings Based (IRB) Approaches" published by CEBS/EBA on 4 April 2006.

224 While institutions opting for the Standardised approach are not required to break down their internal historical loss data by business line, institutions that have opted for the AMA approach must be able to do so in accordance with Article 367, even if they can collect data on loss events using their own internal business line definitions.

225 The effect of insurance is recognised only in the AMA for operational risk. In accordance with Article 371-1, in order for an institution to benefit from a reduction in capital requirements when a protection is in place, the insurance must be provided by a third-party entity. This provision is intended to ensure that the risk is transferred outside the group. "In the case of a captive undertaking or an undertaking belonging to the same group as the subject institution, the exposure must be laid off to an third-party entity outside the group, for example through reinsurance." Similarly, a parent company acting as a protection provider, in order to obtain a reduction in its capital requirements, must transfer the exposure to an independent third-party entity.

226 Under Instruction 2011-I-10 implementing the EBA Guidelines of 6 January 2012 on AMA Extensions and Changes, institutions must inform the ACP of extensions or changes to the models used. Depending on the nature and/or scale of the extensions or changes, prior approval or annual ex-post notification will be required.

List of annexes

Annex A

Press release issued by the Basel Committee on October 27, 1998
Instruments eligible for inclusion in Tier 1 capital

1. The Basel Committee on Banking Supervision has taken note that over the past years some banks have issued a range of innovative capital instruments, such as instruments with step-ups, with the aim of generating Tier 1 regulatory capital that is both cost-efficient and can be denominated, if necessary, in non-local currency. The Committee has carefully observed these developments and at its meeting on October 21, 1998 decided to limit acceptance of these instruments for inclusion in Tier 1 capital. Such instruments will be subject to stringent conditions and limited to a maximum of 15% of Tier 1 capital.

2. As its starting point, the Committee reaffirms that common shareholders' funds, i.e. common stock and disclosed reserves or retained earnings, are the key element of capital. Common shareholders' funds allow a bank to absorb losses on an ongoing basis and are permanently available for this purpose. Further, this element of capital best allows banks to conserve resources when they are under stress because it provides a bank with full discretion as to the amount and timing of distributions. Consequently, common shareholders' funds are the basis on which most market judgements of capital adequacy are made. The voting rights attached to common stock also provide an important source of market discipline over a bank's management. For these reasons, voting common shareholders' equity and the disclosed reserves or retained earnings that accrue to the shareholders' benefit should be the predominant form of a bank's Tier 1 capital

3. To provide supervisors and market participants with sufficient information to ensure that the integrity of capital is maintained, the Committee agrees that, as set forth in its recent report "Enhancing Bank Transparency", banks should periodically publicly disclose each component of Tier 1 capital and its main features.

4. In order to protect the integrity of Tier 1 capital, the Committee has determined that minority interests in equity accounts of consolidated subsidiaries that take the form of SPVs should only be included in Tier 1 capital if the underlying instrument meets the following requirements which must, at a minimum, be fulfilled by all instruments included in Tier 1:

   - issued and fully paid;
   - non-cumulative;
   - able to absorb losses within the bank on a going-concern basis;
   - junior to depositors, general creditors, and subordinated debt of the bank;
   - permanent;
   - neither be 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; and
   - callable at the initiative of the issuer only after a minimum of five years with supervisory approval and under the condition that it will be replaced with capital of same or better quality unless the supervisor determines that the bank has capital that is more than adequate to its risks.

5. In addition, the following conditions have also to be fulfilled:

   - the main features of such instruments must be easily understood and publicly disclosed;
   - proceeds must be immediately available without limitation to the issuing bank, or if proceeds are immediately and fully available only to the issuing SPV, they must be made available to the bank (e.g. through conversion into a direct issuance of the bank that is of higher quality or of the same quality at the same terms) at a predetermined trigger point, well before serious deterioration in the bank's financial position;

– the bank must have discretion over the amount and timing of distributions, subject only to prior waiver of distributions on the bank's common stock and banks must have full access to waived payments; and;

– distributions can only be paid out of distributable items; where distributions are pre-set they may not be reset based on the credit standing of the issuer.

6. Moderate step-ups in instruments issued through SPVs, as well as in directly issued Tier 1 instruments meeting the requirements set forth in paragraphs 4 and 5, are permitted, in conjunction with a call option, only if the moderate step-up occurs at a minimum of ten years after the issue date and if it results in an increase over the initial rate that is no greater than, at national supervisory discretion, either:

   – 100 basis points, less the swap spread between the initial index basis and the stepped-up index basis; or

   – 50% of the initial credit spread, less the swap spread between the initial index basis and the stepped-up index basis.

7. The terms of the instrument should provide for no more than one rate step-up over the life of the instrument. The swap spread should be fixed as of the pricing date and reflect the differential in pricing on that date between the initial reference security or rate and the stepped-up reference security or rate.

8. National supervisors expect banks to meet the Basel minimum capital ratios without undue reliance on innovative instruments, including instruments that have a step-up. Accordingly, the aggregate of issuances of non-common equity Tier 1 instruments with any explicit feature - other than a pure call option - which might lead to the instrument being redeemed is limited - at issuance - to 15% of the consolidated bank's Tier 1 capital.

9. Any instruments authorised or issued under existing national rules of Tier 1 which no longer qualify under the above interpretation will be grandfathered; the same will apply to any issues of such instruments in excess of the 15% limitation.

10. This interpretation will be subject to further review as part of a broader effort already underway to reassess the present framework for evaluating banks' capital adequacy. In this respect, the Committee retains its flexibility to make any changes to this interpretation.

Annex B1

List of French entities treated as part of the central government
(non-exhaustive list)

In accordance with Article 4-1. r) of the Order of 20 February 2007 (amended) : « public sector entities' means non-commercial administrative bodies responsible to central governments, regional governments, or local authorities; authorities that exercise responsibilities similar to those of regional and local authorities; or any other body with similar characteristics ".

In accordance with this definition of "public sector entities", central government services and local State services which belong to the prudential category "central government" (dealt with in Article 11 of the Order of 20 February 2007 (amended) are excluded from the following list.

- Caisse des Dépôts et Consignations
- Caisse Nationale d'Epargne
- IEDOM and IEOM
- CNRS (Centre National de la Recherche Scientifique)
- INRA (Institut National de la Recherche Agronomique)
- CEA (Commissariat à l'Énergie Atomique et aux Énergies Alternatives)
- CNOUSS / CROUSS (Centre National / Régional des Œuvres Universitaires et Scolaires)
- EPFR (Institution Public de Financement et de Restructuration)
- Assistance Publique de Paris and hospitals belonging to it
- Assistance Publique de Marseille
- Hospices Civils de Lyon
- Public health establishments (hospitals, including regional hospitals)
- Private non-profit establishments eligible to participate in the administration of public hospital services, including Centres de Luttle Contre le Cancer
- Caisse Centrale de la Mutualité Sociale Agricole (excluding the Caisses Départementales, which are risk-weighted at 20%)
- Guarantee agencies (COFACE, France Agrimer, ONIMER, Société Interlait)
- GNIS (Groupement National Interprofessionnel des Semences, Graines et Plants)
- GIE MD2 (Groupement d'intérêt économique Marion Dufresne 2)
- INED
- ONF (Office National des Forêts)
- Higher education institutions (Grandes Écoles) incorporated in the form of an institution of public administration, including: Ecole Polytechnique, Ecole Centrale, Ecole Nationale d'Administration, and École Nationale Supérieure des Mines de Paris
- Public institutions of a scientific, cultural, or professional nature listed in Decree 2000-250 dated 15 March 2000
- Fondation Nationale des Sciences Politiques
- Institut Catholique de Lille

– Public institutions of an administrative nature figuring on the list of Organismes Divers d'Administration Centrale in the government accounting

– Claims on social security institutions (ACOSS, CNAV, CNAM, CNAF, UNEDIC, URSSAF, CNRACL, including CADES and ASSEDIC) are also risk-weighted at 0%, with the exception of claims on regional (CARSAT, CRRSI), departmental (CPAM, CAF), and municipal agencies depending on social insurance, which are risk-weighted at 20%.

– AFPA (Association Nationale pour la Formation Professionnelle des Adultes)

– Caisse de Garantie du Logement Locatif Social

– CNIEG (Caisse Nationale de Retraite des Industries Électriques et Gazières)

– Institution Public d'Aménagement de Bordeaux Euratlantique

Annex B2

List of French public sector entities treated as institutions
(non-exhaustive list)

- Services départementaux de secours et de protection contre l'incendie
- Caisses des écoles
- Centre de formation des personnels communaux
- Enseignement secondaire du deuxième cycle – lycées
- Enseignement secondaire du premier cycle – collèges
- Bureaux d'aide sociale
- ODAL "action sociale"
- ODAL "crèches"
- Agence foncière et technique de la région parisienne
- Institution public foncier de la métropole lorraine
- Institution public foncier du Nord – Pas-de-Calais
- Institution public foncier de l'Ouest – Rhône-Alpes
- Institutions publics d'aménagement des villes nouvelles
- Institut d'aménagement et d'urbanisme de la région Île-de-France
- Office de transports de la région Corse
- Institution public d'aménagement de la Défense
- Institution public d'aménagement de Seine-Arche de Nanterre
- Syndicat des transports d'Île-de-France
- Agence d'urbanisme
- Agences des espaces verts de la région Île-de-France
- Agence de l'eau
- Institution public foncier de Normandie
- Centres régionaux de propriété forestière
- Sociétés d'aménagement foncier et d'institution rural (SAFER)
- Chambres d'agriculture
- Chambres de commerce et d'industrie
- Chambres des métiers
- Régie des transports de Marseille
- Caisse nationale des autoroutes
- Autonomous ports
- Réseau ferré de France
- ACFCI (Assemblée des chambres françaises de commerce et d'industrie)
- AMUE (Agence pour la modernisation des universités et des institutions)
- ARTE (Association relative à la télévision européenne)

– OPH (offices publics de l'habitat)

– Agence française de développement as a specialised financial institution (IFS)

Annex C

Correspondence Tables (mappings) applicable to recognised external credit assessment institutions[21]

Annex C1: Banque de France

Annex C2: Coface

Annex C3: Dominion Bond Rating Service (DBRS)

Annex C4: Fitch

Annex C5: Japan Credit Rating Agency (JCR)

Annex C6: Moody’s

Annex C7: Standard and Poor’s

[21] An EBA standard is going to be prepared to update the mapping tables for Standardised approaches (CRR Art. 265) and securitisation (CRR Art. 131-1). Pending its publication on 1 January 2014, the tables in Annex C apply.

Annex C1

BANQUE de FRANCE

Correspondence Table (mapping)

Standardised approach: mapping between the company credit ratings of the Banque de France and the credit quality steps in the Order of 20 February 2007 as amended relating to capital requirements for credit institutions and investment firms.

Long-term exposures

Credit quality step	Banque de France company credit rating	Risk-weight category (Art. 17 a)
1	3++ to 3+	20 %
2	3	50 %
3	4+	100 %
4	4 to 5+	100 %
5	5 to 6	150 %
6	7 to 9	150 %

NB: This correspondence table applies only to companies rated based on accounting documentation. Companies with a credit rating of X0 are risk-weighted at 100%.

Annex C2

Coface[22]

Correspondence Table (mapping)

Standardised approach: mapping between Coface ratings and the credit quality steps in the Order of 20 February 2007 as amended relating to capital requirements for credit institutions and investment firms.

Long-term exposures

Credit quality step	Coface rating	Risk-weight category (Art. 17 a)
1	10 to 9	20 %
2	8	50 %
3	7 to 6	100 %
4	5 to 4	100 %
5	3	150 %
6	2 to 1	150 %

[22] Institutions will no longer be able to use COFACE ratings after the entry into force of the CRR because only external credit assessments issued by an eligible ECAI may be used to calculate capital requirements (cf. Article 130 of draft CRR and EU Regulation 1060/2009 on credit rating agencies).

Annex C3

DOMINION BOND RATING SERVICE (DBRS)

Correspondence Table (mapping)

I/ Standardised approach: correspondence between DBRS ratings and the credit quality steps in the Order of 20 February 2007 as amended relating to capital requirements for credit institutions and investment firms.

Long-term exposures

Credit quality step	DBRS rating	Risk-weight category		
		Corporates (Art. 17a)	Institutions (Art. 16)	Central governments and central banks (Art. 11)
1	AAA to AAL	20 %	20 %	0 %
2	AH to AL	50 %	50 %	20 %
3	BBBH to BBBL	100 %	100 %	50 %
4	BBH to BBL	100 %	100 %	100 %
5	BH to BL	150 %	100 %	100 %
6	Lower than or equal to CCCH	150 %	150 %	150 %

Short-term exposures *(*Art. 17c)

Credit quality step	Risk-weight category	Notation DBRS
1	20 %	R-1 (high), R-1 (average), R-1 (weak)
2	50 %	R-2 (high), R-2 (average), R-2 (weak)
3	100 %	R-3
4	150 %	R-4, R-5
5	150 %	
6	150 %	

II/ Securitisation: mapping between DBRS ratings and the credit quality steps in the Order of 20 February 2007 as amended relating to capital requirements for credit institutions and investment firms.

Long term: Standardised approach (Art. 222)

Credit quality step	Risk-weight category	DBRS rating
1	20 %	AAA to AAL
2	50 %	AH to AL
3	100 %	BBBH to BBBL
4	350 %	BBH to BBL
5	1250 %	Lower than or equal to BH

Long term: Internal Ratings Based approach (Art. 242-1)

Credit quality step	Applicable risk weight			DBRS rating
	A	B	C	
E1	6/7 %	12 %	20 %	AAA
E2	8 %	15 %	25 %	AA (1)
E3	10 %	18 %	35 %	AH
E4	12 %	20 %	35 %	A
E5	20 %	35 %	35 %	AL
E6	35 %	50 %	50 %	BBBH
E7	60 %	75 %	75 %	BBB
E8	100 %	100 %	100 %	BBBL
E9	250 %	250 %	250 %	BBH
E10	425 %	425 %	425 %	BB
E11	650 %	650 %	650 %	BBL
Higher than E11	1250 %	1250 %	1250 %	Lower than BBL

(1) Note: AA includes assessments from AAH to AAL.

Short term: Standardised approach (Art. 222)

Credit quality step	Risk-weight category	DBRS rating
1	20 %	R-1 (high), R-1 (average), R-1 (weak)
2	35 %	R-2 (high), R-2 (average), R-2 (weak)
3	100 %	R-3
All other credit assessments	1250 %	All short-term ratings below R-3

Short term: Internal Ratings Based approach (Art. 242-1)

Credit quality step	Applicable risk weight			DBRS rating
	A	B	C	
E1	6/7 %	12 %	20 %	R-1 (high), R-1 (average), R-1 (weak)
E2	12 %	20 %	35 %	R-2 (high), R-2 (average), R-2 (weak)
E3	60 %	75 %	75 %	R-3
Other	1250 %	1250 %	1250 %	All short-term ratings below R-3

Annex C4

FITCH

Correspondence Table (mapping)

I/ Standardised approach: mapping between Fitch ratings and the credit quality steps in the Order of 20 February 2007 as amended relating to capital requirements for credit institutions and investment firms.

Long-term exposures

Credit quality step	Fitch rating	Risk-weight category		
		Corporates (Art. 17a)	Institutions (Art. 16)	Central governments and central banks (Art. 11)
1	AAA to AA-	20 %	20 %	0 %
2	A+ to A-	50 %	50 %	20 %
3	BBB+ to BBB-	100 %	100 %	50 %
4	BB+ to BB-	100 %	100 %	100 %
5	B+ to B-	150 %	100 %	100 %
6	Lower than or equal to CCC+	150 %	150 %	150 %

Short-term exposures (Art. 17c)

Credit quality step	Risk-weight category	Fitch rating
1	20 %	F1+, F1
2	50 %	F2
3	100 %	F3
4	150 %	Lower than F3
5	150 %	
6	150 %	

II/ Securitisation: mapping between Fitch ratings and the credit quality steps in the Order of 20 February 2007 as amended relating to capital requirements for credit institutions and investment firms.

Long term: Standardised approach (Art. 222)

Credit quality step	Risk-weight category	Fitch rating
1	20 %	AAA to AA-
2	50 %	A+ to A-
3	100 %	BBB+ to BBB-
4	350 %	BB+ to BB-
5 and below	1250 %	Lower than or equal to B+

Long term: Internal Ratings Based approach (Art. 242-1)

Credit quality step	Applicable risk weight			Fitch rating
	A	B	C	
E1	6/7 %	12 %	20 %	AAA
E2	8 %	15 %	25 %	AA
E3	10 %	18 %	35 %	A+
E4	12 %	20 %	35 %	A
E5	20 %	35 %	35 %	A-
E6	35 %	50 %	50 %	BBB+
E7	60 %	75 %	75 %	BBB
E8	100 %	100 %	100 %	BBB-
E9	250 %	250 %	250 %	BB+
E10	425 %	425 %	425 %	BB
E11	650 %	650 %	650 %	BB-
Higher than E11	1250 %	1250 %	1250 %	Lower than BB-

Short term: Standardised approach (Art. 222)

Credit quality step	Risk-weight category	Fitch rating
1	20 %	F1+, F1
2	50 %	F2
3	100 %	F3
All other credit assessments	1250 %	Lower than F3

Short term: Internal Ratings Based approach (Art. 242-1)

Credit quality step	Applicable risk weight			Fitch rating
	A	B	C	
E1	6/7 %	12 %	20 %	F1+, F1
E2	12 %	20 %	35 %	F2
E3	60 %	75 %	75 %	F3
Other	1250 %	1250 %	1250 %	Lower than F3

III/ Undertaking for Collective Investment: mapping between Fitch ratings and the credit quality steps in Article 26 of the Order of 20 February 2007 as amended relating to capital requirements for credit institutions and investment firms.

Credit quality step	Risk-weight category	Fitch rating
1	20 %	AAA to AA-
2	50 %	A+ to A-
3	100 %	BBB+ to BBB-
4	100 %	BB+ to BB-
5	150 %	B+ to B-
6	150 %	Lower than or equal to CCC+

Annex C5

JAPAN CREDIT RATING AGENCY (JCR)

Correspondence Table (mapping)

Standardised approach: mapping between Japan Credit Rating Agency (JCR) ratings and the credit quality steps in the Order of 20 February 2007 as amended relating to capital requirements for credit institutions and investment firms.

Long-term exposures

Credit quality step	JCR rating	Risk-weight category (Art. 17 a)
1	AAA to AA-	20 %
2	A+ to A-	50 %
3	BBB+ to BBB-	100 %
4	BB+ to BB-	100 %
5	B+ to B-	150 %
6	Lower than or equal to CCC	150 %

Short-term exposures

Credit quality step	JCR rating	Risk-weight category (Art. 17 c)
1	J-1	20 %
2	J-2	50 %
3	J-3	100 %
4	All short-term ratings below J-3 (NJ)	150 %
5	All short-term ratings below J-3 (NJ)	150 %
6	All short-term ratings below J-3 (NJ)	150 %

Annex C6

MOODY'S

Correspondence Table (mapping)

I/ Standardised approach: mapping between Moody's ratings and the credit quality steps in the Order of 20 February 2007 as amended relating to capital requirements for credit institutions and investment firms.

Long-term exposures

Credit quality step	Moody's rating	Risk-weight category		
		Corporates (Art. 17a)	Institutions (Art. 16)	Central governments and central banks (Art. 11)
1	Aaa to Aa3	20 %	20 %	0 %
2	A1 to A3	50 %	50 %	20 %
3	Baa1 to Baa3	100 %	100 %	50 %
4	Ba1 to Ba3	100 %	100 %	100 %
5	B1 to B3	150 %	100 %	100 %
6	Lower than or equal to Caa1	150 %	150 %	150 %

Short-term exposures (Art. 17c)

Credit quality step	Risk-weight category	Moody's rating
1	20 %	P-1
2	50 %	P-2
3	100 %	P-3
4	150 %	NP
5	150 %	
6	150 %	

II/ Securitisation: mapping between Moody's ratings and the credit quality steps in the Order of 20 February 2007 as amended relating to capital requirements for credit institutions and investment firms.

Long term: Standardised approach (Art. 222)

Credit quality step	Risk-weight category	Moody's rating
1	20 %	Aaa to Aa3
2	50 %	A1 to A3
3	100 %	Baa1 to Baa3
4	350 %	Ba1 to Ba3
5	1250 %	Lower than or equal to B1

Long term: Internal Ratings Based approach (Art. 242-1)

Credit quality step	Applicable risk weight			Moody's rating
	A	B	C	
E1	6/7 %	12 %	20 %	Aaa
E2	8 %	15 %	25 %	Aa
E3	10 %	18 %	35 %	A1
E4	12 %	20 %	35 %	A2
E5	20 %	35 %	35 %	A3
E6	35 %	50 %	50 %	Baa1
E7	60 %	75 %	75 %	Baa2
E8	100 %	100 %	100 %	Baa3
E9	250 %	250 %	250 %	Ba1
E10	425 %	425 %	425 %	Ba2
E11	650 %	650 %	650 %	Ba3
Higher than E11	1250 %	1250 %	1250 %	Lower than Ba3

Short term: Standardised approach (Art. 222)

Credit quality step	Risk-weight category	Moody's rating
1	20 %	P-1
2	50 %	P-2
3	100 %	P-3
All other credit assessments	1250 %	NP

Short term: Internal Ratings Based approach (Art. 242-1)

Credit quality step	Applicable risk weight			Moody's rating
	A	B	C	
E1	6/7 %	12 %	20 %	P-1
E2	12 %	20 %	35 %	P-2
E3	60 %	75 %	75 %	P-3
Other	1250 %	1250 %	1250 %	All short-term ratings below A3, P3 and F3

III/ Undertaking for Collective Investment: mapping between Moody's ratings and the credit quality steps in Article 26 of the Order of 20 February 2007 as amended relating to capital requirements for credit institutions and investment firms.

Credit quality step	Risk-weight category	Moody's rating
1	20 %	Aaa to Aa3
2	50 %	A1 to A3
3	100 %	Baa1 to Baa3
4	100 %	Ba1 to Ba3
5	150 %	B1 to B3
6	150 %	Lower than or equal to Caa1

Annex C7

STANDARD AND POOR'S

Correspondence Table (mapping)

I/ Standardised approach: mapping between Standard and Poor's ratings and the credit quality steps in the Order of 20 February 2007 as amended relating to capital requirements for credit institutions and investment firms.

Long-term exposures

Credit quality step	S&P rating	Risk-weight category		
		Corporates (Art. 17a)	**Institutions (Art. 16)**	**Central governments and central banks (Art. 11)**
1	AAA to AA-	20 %	20 %	0 %
2	A+ to A-	50 %	50 %	20 %
3	BBB+ to BBB-	100 %	100 %	50 %
4	BB+ to BB-	100 %	100 %	100 %
5	B+ to B-	150 %	100 %	100 %
6	Lower than or equal to CCC+	150 %	150 %	150 %

Short-term exposures (Art. 17c)

Credit quality step	Risk-weight category	S&P rating
1	20 %	A-1+, A-1
2	50 %	A-2
3	100 %	A-3
4	150 %	All short-term ratings lower than A-3
5	150 %	
6	150 %	

II/ Securitisation: mapping between Standard and Poor's ratings and the credit quality steps in the Order of 20 February 2007 as amended relating to capital requirements for credit institutions and investment firms.

Long term: Standardised approach (Art. 222)

Credit quality step	Risk-weight category	S&P rating
1	20 %	AAA to AA-
2	50 %	A+ to A-
3	100 %	BBB+ to BBB-
4	350 %	BB+ to BB-
5 and below	1250 %	Lower than or equal to B+

Long term: Internal Ratings Based approach (Art. 242-1)

Credit quality step	Applicable risk weight			S&P rating
	A	B	C	
E1	6/7 %	12 %	20 %	AAA
E2	8 %	15 %	25 %	AA
E3	10 %	18 %	35 %	A+
E4	12 %	20 %	35 %	A
E5	20 %	35 %	35 %	A-
E6	35 %	50 %	50 %	BBB+
E7	60 %	75 %	75 %	BBB
E8	100 %	100 %	100 %	BBB-
E9	250 %	250 %	250 %	BB+
E10	425 %	425 %	425 %	BB
E11	650 %	650 %	650 %	BB-
Higher than E11	1250 %	1250 %	1250 %	Lower than BB-

Short term: Standardised approach (Art. 222)

Credit quality step	Risk-weight category	S&P rating
1	20 %	A-1+, A-1
2	50 %	A-2
3	100 %	A-3
All other credit assessments	1250 %	All short-term ratings lower than A-3

Short term: Internal Ratings Based approach (Art. 242-1)

Credit quality step	Applicable risk weight			S&P rating
	A	B	C	
E1	6/7 %	12 %	20 %	A-1+, A-1
E2	12 %	20 %	35 %	A-2
E3	60 %	75 %	75 %	A-3
Other	1250 %	1250 %	1250 %	All short-term ratings lower than A-3

III/ Undertaking for Collective Investment: mapping between Standard & Poor's ratings and the credit quality steps in Article 26 of the Order of 20 February 2007 as amended relating to capital requirements for credit institutions and investment firms.

Credit quality step	Risk-weight category	S&P Credit rating for money market funds (1)	S&P Credit rating for other funds
1	20 %	AAA m to AA- m	AAA f to AA- f
2	50 %	A+ m to A- m	A+ f to A- f
3	100 %	BBB+ m to BBB- m	BBB+ f to BBB- f
4	100 %	BB+ m to BB- m	BB+ f to BB- f
5	150 %	B+ m to B- m	B+ f to B- f
6	150 %	Lower than or equal to CCC+ m	Lower than or equal to CCC+ f

(1) As noted in the 2006 report on rating agencies of the French Financial Markets Authority (Autorité des Marchés Financiers – AMF), S&P has a specific approach for money market funds, with the establishment of Principal Stability Fund Ratings.

Annex D

Definition of the equity exposure class[23]

Equity exposures are generally defined as a function of the economic substance of the instrument. They include both direct and indirect ownership interest[24], whether voting or non-voting, in the assets and income of a commercial enterprise or of a financial institution that is not consolidated or deducted from capital[25]. Any instrument that satisfies all of the following conditions is considered to be an equity exposure:

- it is irredeemable in the sense that the return of invested funds can be achieved only by the sale of the investment or sale of the rights to the investment or by the liquidation of the issuer;
- it does not embody an obligation on the part of the issuer;
- it conveys a residual claim on the assets or income of the issuer.

In addition, any of the following instruments must be categorised as an equity exposure:

- any instrument with the same structure as those permitted as Tier 1 capital for banking organisations;
- any instrument that represents an obligation on the part of the issuer and that meets any of the following conditions:
  a) the issuer may defer indefinitely the settlement of the obligation;
  b) the obligation requires (or permits at the issuer's discretion) settlement by issuance of a fixed number of the issuer's equity shares;
  c) the obligation requires (or permits at the issuer's discretion) settlement by issuance of a variable number of the issuer's equity shares and (ceteris paribus) any change in the value of the obligation is attributable to, comparable to, and in the same direction as, the change in the value of a fixed number of the issuer's equity shares;[26]
  d) or the holder has the option to require that the obligation be settled in equity shares, unless either (i) in the case of a traded instrument, the supervisor is content that the bank has demonstrated that the instrument trades more like the debt of the issuer than like its equity, or (ii) in the case of non-traded instruments, the supervisor is content that the bank has demonstrated that the instrument should be treated as a debt position. In cases (i) and (ii), the bank may decompose the risks for regulatory purposes, with the consent of the supervisor.

Debt obligations and other securities, partnerships, derivatives or other vehicles structured with the intent of conveying the economic substance of equity ownership are considered equity holdings[27]. This includes liabilities from which the return is linked to that of equities. Conversely, equity investments that are structured with the intent of conveying the economic substance of debt holdings or securitisation exposures would not be considered equity holdings.

23. Sources: "Guidelines on the implementation, validation and assessment of Advanced Measurement (AMA) and Internal Ratings Based (IRB) Approaches" (CEBS, April 2006) and "International Convergence of Capital Measurement and Capital Standards" (Basel Committee, June 2006, § 235 *et seq*.).

24 Indirect equity interests include holdings of derivative instruments tied to equity interests, and holdings in corporations, partnerships, limited liability companies or other types of enterprises that issue ownership interests and are engaged principally in the business of investing in equity instruments.

25 Where some member countries retain their existing treatment as an exception to the deduction approach, such equity investments by IRB banks are to be considered eligible for inclusion in their IRB equity portfolios.

26 For certain obligations that require or permit settlement by issuance of a variable number of the issuer's equity shares, the change in the monetary value of the obligation is equal to the change in the fair value of a fixed number of equity shares multiplied by a specified factor. Those obligations meet the conditions of item 3 if both the factor and the referenced number of shares are fixed.

27 Equities that are recorded as a loan but arise from a debt/equity swap made as part of the orderly realisation or restructuring of the debt are included in the definition of equity holdings.

Annex E

Historical observation periods required by regulation for the quantification of risk parameters

Minimum historical observation period		At the time of authorisation	On a continuing basis
PD	Retail (Article 125-d)	2 years (increased by one year for each year after authorisation until the data cover a period of 5 years)	5 years
	Corporates (Article 124-h)	IRBF: 2 years (increased by one year for each year after authorisation until the data cover a period of 5 years) IRBA: 5 years	5 years
LGD	Retail (Article 132-d)	2 years (increased by one year for each year after authorisation until the data cover a period of 5 years)	5 years
	Corporates (Article 131)	5 years (increased by one year for each year after authorisation until the data cover a period of 7 years	7 years
Credit conversion factors	Retail (Article 134-2)	2 years (increased by one year for each year after authorisation until the data cover a period of 5 years)	5 years
	Corporates (Article 134-1)	5 years (increased by one year for each year after authorisation until the data cover a period of 7 years)	7 years

Annex F1

List of securities considered sufficiently liquid

The stocks making up the following indices are considered sufficiently liquid:

- CAC 40
- SBF 120 (top 80)
- AEX 25 (Netherlands)
- ASX 100 (top 20) (Australia)
- BEL 20 (Belgium)
- DAX (Germany)
- FTSE 100 (UK)
- Nikkei 225 (top 100) (Japan)
- SP 100 (USA)
- TSE 35 (Canada)

Annex F2

List of indices considered broadly diversified

– CAC 40
– SBF 120
– SBF 250
– MIDCAC
– Second Marché
– AEX 25 (Netherlands)
– ASX 100 (Australia)
– ATX (Austria)
– BEL 20 (Belgium)
– DAX (Germany)
– Eurostoxx (Euro Area)
– FTSE 100 (UK)
– FTSE mid 250 (UK)
– IBEX 35 (Spain)
– Nikkei 225 (Japan)
– OMX (Sweden)
– SP 100 (USA)
– SP 500 (USA)
– SMI (Switzerland)
– TSE 35 (Canada)

Annex G

EBA Guidelines on capital adequacy under Pillar 1

– *16 May 2012: EBA Guidelines on Stressed Value-At-Risk (Stressed VaR)*

– *16 May 2012: EBA Guidelines on the Incremental Default and Migration Risk Charge (IRC)*

– *6 January 2012: EBA Guidelines on the Advanced Measurement Approach (AMA) – Extensions and Changes (GL 45)*

– *31 December 2010: CEBS Guidelines on the Application of Article 122a of the Capital Requirements Directive (CRD)*

– *30 November 2010: Revised Guidelines on the Recognition of ECAIs*

– *12 October 2010: CEBS Guidelines on the Management of Operational Risks in Market-Related Activities*

– *14 June 2010: CEBS Guidelines on Instruments referred to in Article 57(a) of the CRD*

– *22 December 2009: CEBS Guidelines on Operational Risk Mitigation Techniques*

– *10 December 2009: CEBS Guidelines on Hybrid Capital Instruments*

– *8 September 2009: CEBS Compendium of Supplementary Guidelines on Implementation Issues of Operational Risk*

– *3 October 2006: CEBS Technical Guideline on Interest Rate Risk in the Banking Book*

– *4 April 2006: CEBS Guidelines on Validation*

Annexe H

Amendments of the Notice introduced in the course of the year

- Original version of 2013-01-16 (adopted by the *Collège Banque* of the ACP)
- Version of 2013-02-22 : amendment of § 7
- Version 2013-03-26 : amendment of annex B1 and annex C