Consultation

Basel III: Capital Adequacy and Leverage

This consultation will be of particular relevance to class 1 licenceholders (deposit takers) incorporated in the Isle of Man

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Financial Supervision Commission Barrantee Oaseirys Argidoil

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SECTION 1 - INTRODUCTION

1.1 Background

1.1.1 Overview

This paper contains proposals to revise the framework for capital adequacy (including introduction of reporting a leverage ratio) for banks incorporated in the Isle of Man ("**IOM Banks**"), to address changes in international standards in this area as published by the Basel Committee on Banking Supervision ("**Basel Committee**") as part of the package of reforms known as "**Basel III**".

The proposals, if implemented, will result in some consequential changes to Rules that apply, and new reporting requirements. The Financial Supervision Commission ("**Commission**") wishes to introduce the proposals, as detailed in **section 2** and the **appendices**, in 2017.

1.1.2 What is driving the proposals?

Following the issuance of Basel II, the Commission worked with the Guernsey Financial Services Commission ("**GFSC**") and Jersey Financial Services Commission ("**JFSC**"), jointly the "**Tri-party Group**", to establish a unified approach wherever possible to implementing Basel II during the period 2005-2008. As a result of this work the current regulatory capital framework in the Isle of Man is consistent with Basel II.

Since 2008 the Basel Committee worked to revise Basel II to strengthen the framework and address lessons of the financial crisis. This work has resulted in a number of documents being issued that revise Basel II or establish new international standards regarding the financial wellbeing of international banks. Collectively, this initiative is described by the Basel Committee as "Basel III", and it encompasses both capital adequacy and liquidity measures.

The Tri-Party Group distributed a Discussion Paper on Basel III in September 2012 (the "**Initial DP**"), to provide information on Basel III and an indication of the Tri-Party Group's initial views (and to solicit feedback).

The Tri-Party Group has issued four further discussion papers containing more detailed proposals building on those in the Initial DP. A Discussion Paper on Basel III: Capital Adequacy (**"Capital Adequacy DP")** was issued in December 2013, followed in January 2014 by a Discussion Paper on Domestic Systemically Important Banks (including Recovery and Resolution). In June 2014 a further Discussion Paper on Basel III: Leverage Ratio ("**Leverage DP**") was issued. The Tri-Party Group reviewed comments provided by banks to the above Discussion Papers and issued

feedback papers. Most recently, a Discussion Paper on Liquidity was issued in July 2015.

The proposals in this consultation paper are derived primarily from those contained in the Initial DP, Capital Adequacy DP and Leverage DP, and also take into account the feedback issued.

1.1.3 Cost / benefit analysis

Costs to industry

Based on feedback provided and data collected, the cost of the capital requirements proposed is limited because the impact is small or can be managed through changes to instruments, and IOM Banks are part of groups that are or will be subject to similar capital standards.

In particular, in most cases where capital instruments would become ineligible under these proposals, they would also become ineligible on consolidation. This limits the cost of the proposals, since retaining current rules would not address this.

Therefore, for most IOM Banks the principal cost will relate to the production of revised reporting. Delaying implementation to 2017 is intended to ease this process and enable costs to be contained.

Costs to the Commission

The Commission will need to revise its prudential reporting set and make sure that this tested robustly. It will also need to introduce some revisions to Rules. Delaying implementation to 2017 will likewise ease this process and enable costs to be contained.

Benefits to industry

Industry benefits indirectly from demonstrable compliance with international standards, reinforcing the Isle of Man's reputation, and that of its banking industry, as a safe, well regulated home for deposits.

Enhancing capital quality reduces the likelihood of bank failures. This benefits banks, through guarding against the consequences of a failure. Ultimately this reduces the likelihood of bank runs and also direct costs, such as in connection with any call on deposit compensation schemes.

Benefits to the Commission

The Commission does not consider capital quality to currently be a significant issue in the Isle of Man, as banks typically rely almost entirely on higher quality capital.

However, the recent crisis highlighted the role of capital quality shortcomings in the failure of banks. Introducing these proposals guards against the risk that capital quality deteriorates. It also reduces the need to consider other supervisory responses to this risk, such as through the SREP process.

Question 1

Are there any specific measures that should be considered that would either increase the benefits of the proposals or reduce any of the associated costs of implementation?

1.1.4 Glossary of terms

Additional Tier 1 capital / AT1	Items permitted within Tier 1 capital, other than CET1 capital
Basel Committee	Basel Committee on Banking Supervision
Basel II	"*International Convergence of Capital Measurement and Capital Standards*", re-issued in comprehensive form in June 2006 by the Basel Committee
Basel III	Collectively, a series of documents issued by the Basel Committee that either revise Basel II or establish new international standards regarding the financial management of international banks
Capital Adequacy DP	"*Basel III: Capital Adequacy*", distributed in December 2013 by the Tri-Party Group
CDs	Crown Dependencies – Guernsey, Isle of Man and Jersey
CET1	Common (or core) Equity Tier 1
Commission	Isle of Man Financial Supervision Commission
D-SIB	Domestic Systemically Important Bank
DTAs	Deferred tax assets
DTLs	Deferred tax liabilities
DVA	Debit valuation adjustment
DVA Statement	Press release issued by the Basel Committee following its consultation on the treatment of DVAs
GFSC	Guernsey Financial Services Commission
ICAAP	Internal Capital Adequacy Assessment Process
ICG	Individual Capital Guidance
Initial DP	Discussion Paper on Basel III, issued by the Tri-Party Group in September 2012.
IOM Banks	Isle of Man incorporated deposit takers (banks)
JFSC	Jersey Financial Services Commission
Leverage DP	"*Basel III Leverage Ratio*", distributed in June 2014 by the Tri-Party Group

Rules / Rule	Current rules as contained in the Financial Services Rule Book
RWAs	Risk Weighted Assets
SREP	Supervisory review and evaluation process (for ICAAP)
Tri-Party Group	Comprises the Commission, GFSC and JFSC
T2	Tier 2 capital (used in forms only)

1.2 High level rationale

The Commission's regulatory objectives are set out in section 2 to the Financial Services Act 2008. These are:

(a) securing an appropriate degree of protection for the customers of persons carrying on a regulated activity;
(b) the reduction of financial crime; and
(c) supporting the Island's economy and its development as an international finance centre.

The proposals in this paper support objectives *(a) and (c)*. In addition to this, under paragraph 3 of Schedule 1 to the Financial Services Act 2008, the Commission is required to give consideration to certain factors.

The table below sets out the list of factors contained in paragraph 3 of Schedule 1 that have a bearing on the proposals.

FACTOR	**INFORMATION**
The need for the regulatory, supervisory and registration regimes to be effective, responsive to commercial developments and proportionate to the benefits which are expected to result from the imposition of any regulatory burden.	The proposals are designed to implement international standards whilst being proportionate, achieved by providing a suitable timeframe before being introduced, and broadly covering matters already discussed with industry.
The need to use Commission resources in the most effective and economic way.	The timeframe for implementing the proposals, and working together with the JFSC and GFSC, means that the Commission is able to use its existing resources.
The desirability of implementing and applying recognised international standards.	The proposals are designed to implement international standards for capital adequacy, whilst taking into account the fact that the Commission is primarily a host supervisor.

The desirability of cooperating with governments, regulators and others outside the Island.	The proposals will align the Isle of Man's framework to international standards for capital, helping cooperation and understanding.
The need to safeguard the reputation of the Island.	The proposals are designed to implement international standards for capital adequacy which strengthen the regime for the benefit of the reputation of the Island.
The international character of financial services and markets and the desirability of maintaining the competitive position of the Island.	It is not considered the competitive position of the Island will be impacted, as the proposals are designed to implement the new minimum international standards.
The impact of its decisions on the stability of the financial system of the Island.	The proposals are designed to implement international standards for capital adequacy which strengthen the regime and improve the stability of the financial system of the Island.

1.3 Consultation Process

The Commission views open dialogue with industry and other stakeholders as an essential element in developing an optimal regulatory framework. The Commission therefore appreciates the time spent reading and commenting upon these proposals.

The proposals, together with a series of important questions are set out in section 2. While comments should cover the specific questions, any general comments and observations will be welcomed.

The closing date for comments is **30 October 2015**.

We would be most grateful if comments could be received as soon as possible and **no later than the above date**.

Responses should be sent in writing or by e-mail to:

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The purpose of consultation is to obtain views and gather evidence from which to take an informed decision on the content of proposed legislation and associated guidance. A response to this consultation will not necessarily result in a change to the proposals.

A summary of the comments received along with the Commission's response will be published on the Commission's website after all comments have been considered.

Anonymous submissions will not be considered or included in the summary of comments. As public identification of respondents may lead to fewer responses, **no respondents will be publicly identified**.

SECTION 2 - PROPOSALS

2.1 Executive summary

2.1.1 Overview

This paper contains full details of proposals to amend the minimum regulatory capital adequacy requirements that apply to **IOM Banks**.

The proposals are primarily derived from those contained in three Discussion Papers (and associated feedback), issued by the Tri-Party Group, namely the **Initial DP**, **Capital Adequacy DP** and **Leverage DP**.

2.1.2 What is proposed, and why?

The Commission proposes changes to the definition of capital, with the introduction of:-

- A definition for the highest quality capital known as Common Equity Tier 1 ("CET1"); and
- Tighter eligibility conditions for capital in general, including for Tier 1 and Tier 2 (and therefore total capital).

The Commission also proposes to introduce new minimum capital requirements including specific minima for CET1 and Tier 1 ratios and a total capital requirement of at least 10% for all IOM Banks (with a minimum notification level of at least 11%). It is also proposed that IOM Banks should start to report a Leverage Ratio, but no minimum requirement will be established.

Finally, some consequential changes to risk weighted assets and large exposures are proposed, and an outline of other changes that may arise from Basel III are explored.

The changes proposed will mostly impact on quarterly reporting (forms and associated guidance) with some associated minor changes to Rules also being required.

The Commission's proposals are discussed in detail under the following headings:-

- Definition of capital (capital quality) and consequential changes to risk weighted assets – section 2.2
- Minimum capital requirements – section 2.3
- Leverage ratio – section 2.4
- Large exposures and relationship to capital – section 2.5

- Other capital adequacy related proposals in Basel III – section 2.6

The proposals are intended to align local requirements with international standards and, in doing so, maintain alignment where possible across the Crown Dependencies and with home country jurisdictions; the latter having either already implemented Basel III in the above areas, or have committed to do so.

2.1.3 When will changes come into effect?

The Commission proposes to introduce the changes in 2017, which will provide IOM Banks (and the Commission) with sufficient time to make changes to reporting systems and carry out testing.

This timeline also addresses feedback to the Capital Adequacy DP, where some banks suggested simplifying transitional adjustments and having more time to comply. As a result of this the Commission does not propose to implement transitional measures; the impact of this is covered in sections 2.2.2 and 2.3.3.

2.1.4 Who would be affected?

All IOM Banks will be impacted by the requirements and changes to reporting but, based on prudential data held by the Commission and feedback to both the Capital Adequacy DP and Leverage DP, the impact on banks' capital will be manageable.

The proposals could have a higher impact on capital adequacy for IOM Banks that:-

- Have issued ineligible instruments (under the proposed rules);
- Currently rely to a higher extent on lower quality capital; or
- Currently benefit significantly from the use of some prudential filters / adjustments (in relation to pension deficits and mark to market losses on available for sale instruments).

2.2 Definition of capital (capital quality) and consequential changes to risk weighted assets

2.2.1 Overview

The Capital Adequacy DP set out in detail proposed new capital definitions, revised reporting forms and completion guidance. The overwhelming majority of respondents accepted these proposals and therefore the Commission intends to adopt these, subject to the minor changes outlined in 2.2.2 below to reflect feedback provided.

The main changes to the definition of capital, compared to the current Basel II approach are consistent with those covered in the Capital Adequacy DP, being:-

a) The introduction of a new sub-category of capital with the highest quality (CET1);
b) Tighter definitions for issued capital (Tier 1 and Tier 2);
c) Removal of provisions formerly permitted regarding pensions and held for sale reserves; and
d) New requirements for deductions in connection with deferred tax assets and minority interests.

There are also some minor consequential changes to risk weighted assets arising from the above.

2.2.2 Proposals, including a summary of changes from the Capital Adequacy DP

Reporting forms and completion guidance – capital definition

IOM Banks will be required to report their capital quality to the Commission on a quarterly basis, as part of the prudential reporting requirements contained under Rule 2.24. A proposed reporting form and completion guidance for all aspects is contained in ***appendix 1***. These are broadly consistent with the proposals contained in the Capital Adequacy DP; a summary of the key changes is provided below.

The proposed reporting form will replace the capital part of the current reporting form known as Form SR-2A. For the purpose of this paper, the proposed form remains labelled as Form SR-2A.

Question 2

Do you have any comments regarding the proposed capital definitions as set out in appendix 1?

Proposed minor revisions to risk weighted assets (Form SR-1B)

The minor changes proposed in this paper relate to the risk weighting of certain items previously deducted from capital under Basel II.

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

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

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

The new 250% and 1,250% risk weighted items will be reported in section K of Form SR-1B. Previous references to capital deductions contained in Form SR-1B will also be removed when the new reporting forms are introduced, so that Form SR-1B covers risk weighted assets only.

Extracts of the revised reporting form and guidance are provided at ***appendix 2***.

Note that the proposed revisions to RWAs in this paper do not cover most of the Basel III changes to risk weightings. Many of the other Basel III changes (with the exception of potential changes to the standardised approach to credit risk - ***see section 2.6***) would only have a significant impact on banks with trading books or those involved in securitisation, the local impact of which is expected to be extremely limited.

Question 3

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

Summary of key changes (including clarification of matters) from the Capital Adequacy DP

- *Transitional provisions*

Feedback from industry to the Capital Adequacy DP suggested simplifying transitional provisions and the Commission is proposing to introduce the new requirements in 2017. This implementation date reduces the impact of most transitional provisions to only 20%, although for issued debt there is a longer period. However, all significant debt issuance by IOM Banks is within group and the Commission considers that a period to 2017 provides adequate time to replace such debt with Basel III compliant instruments.

Therefore, it is not proposed to introduce transitional provisions, which will simplify the reporting process and forms. All lines contained in the Capital Adequacy DP that referred to transitional items have therefore been removed in the reporting forms contained in this paper.

Question 4

Would a 2017 deadline provide sufficient time to replace affected instruments (normally being instruments currently held as Tier 2 subordinated debt)? If not, please provide an alternative (also see related question 6).

- *Prohibition of funding own capital*

The eligibility criteria for all forms of regulatory capital in Basel III explicitly prohibit instruments being included where funding has been provided by the bank, directly or indirectly, for the purchase of the instrument. Sometimes, group holding companies hold the capital instruments issued by IOM Banks. For clarity, if funding (direct or indirect) is provided by an IOM Bank to a holding company (excluding regulated banks that holds, directly or indirectly, capital instruments issued by the IOM Bank, then an amount of the capital instrument equal to the amount of funding provided will not be permitted to be included for capital purposes. This addresses the risk that capital quality is reduced due to circular funding arrangements.

The above treatment is contained in the completion notes in ***appendix 1, annexes A, B and C***.

Question 5

Does your bank provide any funding to holding companies that directly or indirectly hold capital instruments issued by it? If so, please comment on the impact of the above and steps that you can take to mitigate the impact, including withdrawing funding.

- *Write down at point of non-viability*

AT1 and Tier 2 instruments must be capable of being written down or converted to common equity. The difference is that for AT1 the trigger for such action is higher, with the aim of maintaining CET1 capital adequacy, whereas for Tier 2 the trigger is non-viability.

Two routes are permitted in Basel III: instruments can have contractual provisions for write down at the trigger point, or the jurisdiction must have a statutory power to write down relevant instruments.

In the Isle of Man there is no current statutory route available. Therefore, whilst this remains the position, for AT1 and Tier 2 instruments to be eligible they must have embedded contractual terms that would trigger a conversion or write down. For AT1 instruments the trigger will be a breach of the CET1 minimum of 8.5% and for Tier 2 the trigger is proposed to be 4.25% of CET1. Full detail is contained in the completion notes in ***appendix 1, annexes B and C***.

Question 6

Would a 2017 deadline provide sufficient time to replace or amend any capital issuance that does not meet the proposed standards for regulatory capital?

2.3 Minimum capital requirements

2.3.1 Overview

The Capital Adequacy DP set out proposed statutory minima ratios of 8.5% for CET1 and Tier 1 capital, and 10% for total capital. The overwhelming majority of respondents accepted these proposals and therefore the Commission intends to adopt these.

The proposals will result in IOM Banks having to hold higher levels of capital under Pillar 1 of the capital adequacy framework, as the current total capital ratio is set at 8%. However, the Commission has consistently applied a measure such that all IOM Banks have had to observe a notification level of at least 10% (if their prescribed total capital ratio is 9% or below) and has moved this more recently to 10.5% as part of planning for Basel III, and in setting ICG.

The Commission will continue to require that IOM Banks provide notification if capital levels come to within a set percentage of the minima that have been applied. Amendments will also be needed in respect of Pillar 2.

2.3.2 Proposals: pillar 1

a) A minimum statutory CET1 ratio and Tier 1 ratio of 8.5% will apply to IOM Banks. This is before any capital add-ons made under Pillar 2 on a bank specific basis.

b) A minimum statutory total capital ratio (Tier 1 plus Tier 2) of 10% will apply to IOM Banks. This is before any capital add-ons made under Pillar 2 on a bank specific basis.

c) A notification level of at least 1% above the minima for total capital will continue to apply, as per the Commission's current framework (refer Rule 2.23(3)). A notification level will not be applied as a matter of course against CET1 and Tier 1 capital, as the minima proposed already include the full capital conservation buffer under Basel III (see "d" below).

d) The Commission is not proposing to introduce a separate capital conservation buffer regime and has set the minima requirements at levels to take account of that.

e) The Commission is also not proposing to introduce a countercyclical buffer, consistent with the approach proposed in the Capital Adequacy DP.

f) It should however be noted that, in due course, a consultation paper on **D-SIBs** will be published building on the previously issued Tri-Party Group Discussion Paper issued in January 2014. Proposals may include the setting of higher

loss absorbency capital requirements where an IOM Bank is identified as a D-SIB.

g) IOM Banks will be required to report their capital ratios to the Commission on a quarterly basis, as part of the prudential reporting requirements contained under the Rule 2.24. A proposed reporting form for capital ratios, definitions and completion guidance is provided in ***appendix 3***. These are broadly consistent with the proposals contained in the Capital Adequacy DP (although the format in appendix 3 is more consistent with the Commission's style). The proposed reporting form will replace part of the current reporting form known as Form SR-2C. For the purpose of this paper, the proposed form remains labelled as Form SR-2C.

h) The Commission will also need to make associated changes to the Rule Book, and these are covered in ***appendix 5***.

For completeness, a table comparing the Commission's proposals with Basel III is shown below:-

Capital ratio	Commission proposed minima[1]	Basel III minima *(inclusive of capital conservation buffer of 2.5%)*[2]	Notes
CET1	8.5%	7%	The majority of IOM Banks' capital is in the form of CET1, and therefore the CET1 ratio has been set at the same level as the Tier 1 ratio (which is at 8.5%, consistent with Basel III).
Tier 1	8.5%	8.5%	
Total (Tier 1 plus Tier 2)	10%	10.5%	Although a 10% minimum is proposed, the Commission will continue to require banks to observe a "trigger ratio", which will result in compliance with the Basel III minima of 10.5% (and provide a small cushion before the 10.5% level is reached).
Notification level	At least 1% above the minima above (i.e. 11%)	N/A	

[1] The Commission is not proposing to introduce a capital conservation buffer and the associated rules / requirements that are needed to go alongside that, which is consistent with the proposals in the Capital Adequacy DP. As a result the proposed minima have been set taking into account the Basel III minima inclusive of the capital conservation buffer.

[2] Under Basel III, banks will be allowed to use the capital conservation buffer in times of stress (with appropriate constraints put in place) but must remedy the position such that the buffer is preserved.

Question 7

Do you have any comments regarding the proposed Pillar 1 capital requirements, including with reference to the forms and guidance in appendix 3 and the rules in appendix 5?

2.3.3 Proposals: pillar 2

IOM Banks will still be required to assess their capital needs through the ICAAP, and the Commission will continue to apply Pillar 2 additional capital add-ons, and any planning buffers (in addition to the 1% statutory notification requirement under Rule 2.23(3)), on an individual bank basis as part of the SREP. Typically, any increase required will be applied equally to all three capital minima (CET1, Tier 1 and Total Capital).

The Commission will continue to express ICG as a percentage of RWAs (and also as a percentage of the Pillar 1 requirement for information purposes) and may, in addition, prescribe Pillar 2 add-ons in terms of fixed capital amounts or alternatively require specific amounts to be deducted from capital items (refer reporting form SR-2A, line A.26 in appendix 1 as an example for CET1 deductions arising from Pillar 2).

Transitional arrangements (for ICG)

Upon implementation of the revised minima (Pillar 1) capital requirements as specified in **section 2.3.2**, the Commission will perform a review of IOM Banks' currently prescribed ICG. The Commission will consider where the current Pillar 2 add-ons relate to inadequacy of Pillar 1 requirements (e.g. credit risk, operational risk) and these add-ons may be revised downwards where the new higher Pillar 1 requirements may adequately address a particular risk.

As is currently the case, IOM Banks' ICAAPs should continue to include consideration of whether the capital requirement generated by the Pillar 1 calculation gives a realistic picture of risk exposure, with respect to risks within the scope of Pillar 1. The effective increase in Pillar 1 requirements (as the current total statutory minima in the Isle of Man is 8%, not 10% as proposed in this paper), may require banks to revise their assessments in future ICAAP iterations (post 2016).

Guidance

The Commission's guidance note on ICAAP and SREP will need to be updated in due course, and before implementing the proposals contained in this paper.

Question 8

Do you have any comments regarding the proposed Pillar 2 approach, noting that the guidance on Pillar 2 (ICAAP and SREP) will be updated in due course?

2.4 Leverage ratio

2.4.1 Overview

The Leverage DP set out proposals for reporting of a leverage ratio, in line with the requirements contained in the Basel Committee paper *"Basel III leverage ratio framework and disclosure requirements"* ("***Leverage Disclosure Rules***") issued in January 2014.

The leverage ratio is a ratio of capital (Tier 1) versus an exposure measure, on a non-risk weighted basis. Feedback to the Leverage DP was generally positive, noting that there was no proposal to introduce a formal binding minimum requirement at this stage. The feedback has resulted in only a minor change being incorporated into the proposals as outlined in 2.4.2 (c) below.

2.4.2 Proposals

a) IOM Banks will be required to report a leverage ratio to the Commission on a quarterly basis, as part of the prudential reporting requirements contained under the Rule 2.24. No new Rules will be required to be made to implement the reporting requirement.

b) No minimum leverage ratio is proposed but the Commission may take banks' degree of leverage into account as part of the supervisory review and assessment of capital under Pillar 2, noting the international minima of 3%.

c) A proposed reporting form (labelled Form SR-2D for the purpose of this paper), definitions and completion guidance is provided in ***appendix 4***. These are consistent with the proposals contained in the Leverage DP with the exception that the completion guidance has been amended to permit netting to be fully recognised to the extent permitted by the Leverage Disclosure Rules. This is covered in ***appendix 4***.

Question 9

Is the form and guidance in appendix 4 sufficiently clear? If not, please provide details of where you think it could be improved / made clearer.

2.5 Large exposures (and relationship to capital)

2.5.1 Overview

The Basel Committee's standard "Supervisory framework for measuring and controlling large exposures" published in April 2014, established that large exposure rules should apply with reference to Tier 1 capital. The stated rationale for this is:-

"The aim of a large exposures standard is to ensure that a bank can absorb losses resulting from the sudden failure of a single counterparty or group of connected counterparties without itself failing. Consistent with this aim, the Basel Committee believes that the capital base on which the large exposure limit is calculated should consist only of capital that can absorb unexpected losses on a going concern basis."

The Commission's Rules pertaining to large exposures refer to the capital measurement as being with reference to the "large exposures capital base" ("**LECB**"). The LECB is based on total capital (audited), not Tier 1.

Except in the above area, the large exposure framework in the Isle of Man is broadly aligned with the revised Basel Committee standard (the revised standard does not address sovereign or intra-group exposures), noting that some minor improvements in the reporting of large exposures will be made (**see 2.5.2 below**).

2.5.2 Proposals

a) The Commission proposes to change the definition of LECB such that it is referenced to the new definition of Tier 1 capital as outlined in this paper. The associated changes to the Rule Book are covered in ***appendix 5***.

b) As part of the process whereby reporting forms and completion notes will be changed, the Commission will also review the current reporting form for large exposures (Form SR-2B) and make changes to reflect the Basel Committee's revised standard. Examples of where improved reporting could be made will be in relation to reporting exposure values before and after eligible collateral. These changes are expected to be minor.

Question 10

Is the period to 2017 sufficient to manage any impact arising from the change to using Tier 1 capital for the purpose of determining the LECB?

2.6 Other capital adequacy related proposals in Basel III (and Basel 2.5)

Basel III includes various reforms published by the Basel Committee (either in final form or for consultation) that will supplant those established in Basel II. The main papers that revise elements relevant to capital adequacy are shown in the table below:-

Core Topic (for capital, including RWAs)	**Publication**	**Issue Date**
Credit risk	Revisions to the standardised approach for credit risk – consultation	December 2014
Credit risk	Capital floors: the design of a framework based on standardised approaches - consultation	December 2014
Credit risk	Revisions to the securitisation framework	December 2014
Credit risk	The standardised approach for measuring counterparty credit risk exposures	March 2014
Credit risk	Capital requirements for banks' equity investments in funds – final standard	December 2013
Credit risk	Capital requirements for bank exposures to central counterparties	July 2012
Credit risk	Basel III: a global regulatory framework for more resilient banks and banking systems (the first Basel III publication)	December 2010 and revised June 2011
Credit risk	Enhancements to the Basel II framework (known as Basel 2.5)	July 2009
Market risk	Fundamental review of the trading book: outstanding issues - consultation	December 2014
Market risk	Fundamental review of the trading book: second consultative document (and related first document)	October 2013
Market risk	Revisions to the Basel II market risk framework (part of Basel 2.5)	July 2009
Operational risk	Operational risk: revisions to the simpler approaches - consultation	October 2014

The Commission considers that the first of the papers referred to in the table above: "Revisions to the standardised approach for credit risk – consultation" has the potential to have a significant impact on IOM Banks. This is because it sets out proposals for a new standardised approach for calculating RWAs in respect of credit risk. Such RWAs represent the largest component of RWAs for all IOM Banks.

The Commission provided a summary of the proposed changes contained in that consultation document to the Isle of Man Bankers' Association on 27 February 2015.

Other documents covered in the table above will be addressed, where they are relevant, through discussion and consultation papers to be issued by the Commission. Where possible, it is intended to issue Tri-Party discussion papers on issues that could have a significant impact on banks in all three islands, and where a common approach is identified.

Question 11

Are you aware of any elements of the Basel III package of reforms that you consider wither a) warrants earlier introduction or b) should not be introduced in the Isle of Man?

APPENDIX 1 – REPORTING FORM AND COMPLETION GUIDANCE – CAPITAL DEFINITION

Reporting Form

FORM SR-2A (extract): CAPITAL DEFINITION (CET1, ADDITIONAL TIER 1, TIER 2, TOTAL CAPITAL, MEMORANDUM ITEMS)

A	**Common Equity Tier 1 capital: instruments and reserves**	**Amount £'000**	**Amount £'000**
A.1	Directly issued qualifying common share capital (and equivalent for non-joint stock companies) plus related stock surplus		
A.2	Retained earnings		
A.3	Accumulated other comprehensive income (and other reserves)		
A.4	Common share capital issued by subsidiaries and held by third parties (amount allowed in group CET1)		
A.5	**Common Equity Tier 1 capital before regulatory adjustments**	**0**	
A.6	**Less : Common Equity Tier 1 capital: regulatory adjustments**		
A.7	Prudential valuation adjustments		
A.8	Goodwill (net of related tax liability)		
A.9	Other intangibles, other than mortgage-servicing rights (net of related tax liability)		
A.10	Deferred tax assets that rely on future profitability excluding those arising from temporary differences (net of related tax liability)		
A.11	Cash-flow hedge reserve		
A.12	Shortfall of provisions to expected losses		
A.13	Securitisation gain on sale (as set out in para 562 of Basel II framework)		
A.14	Gains and losses due to changes in own credit risk on fair valued liabilities		
A.14a	*of which: amount relating to DVAs recognised on origination*		
A.15	Defined-benefit pension fund net assets		
A.16	Investments in own shares (if not already netted off paid-in capital on reported balance sheet)		
A.17	Reciprocal cross-holdings in common equity		
A.18	Investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation, net of eligible short positions, where the bank does not own more than 10% of the issued common share capital of the entity (amount above 10% threshold)		
A.19	Significant investments in the common stock of banking, financial and insurance entities that are outside the scope of regulatory consolidation, net of eligible short positions (amount above 10% threshold)		
A.20	Mortgage servicing rights (amount above 10% threshold)		
A.21	Deferred tax assets arising from temporary differences (amount above 10% threshold, net of related tax liability)		
A.22	Amount exceeding the 15% threshold		
A.23	*of which: signifcant investments in the common stock of financials*		
A.24	*of which: mortgage servicing rights*		
A.25	*of which: deferred tax assets arising from temporary differences*		
A.26	National specific regulatory adjustments, including Pillar 2 deductions applied to CET1 capital		
A.27	Regulatory adjustments applied to Common Equity Tier 1 due to insufficient Additional Tier 1 and Tier 2 to cover deductions	0	*generated from line B.13a*
A.28	**Total regulatory adjustments to Common Equity Tier 1**	**0**	
A.29	**COMMON EQUITY TIER 1 CAPITAL (CET1)**	**0**	

B	Additional Tier 1 capital: instruments	Amount £'000	Amount £'000
B.1	Directly issued qualifying Additional Tier 1 instruments plus related stock surplus		
B.2	*of which: classified as equity under applicable accounting standards*		
B.3	*of which: classified as liabilities under applicable accounting standards*		
B.4	Additional Tier 1 instruments (and CET1 instruments not included in A.4) issued by subsidiaries and held by third parties (amount allowed in AT1)		
B.5	**Additional Tier 1 capital before regulatory adjustments**	**0**	
B.6	**Less: Additional Tier 1 capital: regulatory adjustments**		
B.7	Investments in own Additional Tier 1 instruments		
B.8	Reciprocal cross-holdings in Additional Tier 1 instruments		
B.9	Investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation, net of eligible short positions, where the bank does not own more than 10% of the issued common share capital of the entity (amount above 10% threshold)		
B.10	Significant investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation (net of eligible short positions)		
B.11	National specific regulatory adjustments, including Pillar 2 deductions applied to Additional Tier 1 capital		
B.12	Regulatory adjustments applied to Additional Tier 1 due to insufficient Tier 2 to cover deductions	0	*generated from line C.11a*
B.13	**Total regulatory adjustments to Additional Tier 1 capital**	**0**	
B.13a	*of which: excess AT1 deductions*		0
B.14	**ADDITIONAL TIER 1 CAPITAL**	**0**	
B.15	**TIER 1 CAPITAL**	**0**	

C	Tier 2 capital: instruments and provisions	Amount £'000	Amount £'000
C.1	Directly issued qualifying Tier 2 instruments plus related stock surplus		
C.2	Tier 2 instruments (and CET1 and AT1 instruments not included in A.4 and B.4) issued by subsidiaries and held by third parties (amount allowed in group Tier 2)		
C.3	Provisions		
C.4	**Tier 2 capital before regulatory adjustments**	**0**	
C.5	**Less: Tier 2 capital: regulatory adjustments**		
C.6	Investments in own Tier 2 instruments		
C.7	Reciprocal cross-holdings in Tier 2 instruments		
C.8	Investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation, net of eligible short positions, where the bank does not own more than 10% of the issued common share capital of the entity (amount above 10% threshold)		
C.9	Significant investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation (net of eligible short positions)		
C.10	National specific regulatory adjustments, including Pillar 2 deductions applied to Tier 2 capital		
C.11	**Total regulatory adjustments to Tier 2 capital**	**0**	
C.11a	*of which: excess Tier 2 deductions*		0
C.12	**TIER 2 CAPITAL**	**0**	

D	TOTAL CAPITAL	0	

E	Capital Memorandum Items	Amount £'000	Amount £'000
	Amounts below the thresholds for deduction (before risk weighting)		
E.1	Non-significant investments in the capital of other financial institutions		
E.2	Significant investments in the common stock of financial institutions		
E.3	Mortgage servicing rights (net of related tax liability)		
E.4	Deferred tax assets arising from temporary differences (net of related tax liability)		
	Applicable caps on the inclusion of provisions in Tier 2		
E.5	Provisions eligible for inclusion in Tier 2 in respect of exposures subject to standardised approach (prior to application of cap)		
E.6	Cap on inclusion of provisions in Tier 2 under standardised approach		
E.7	Provisions eligible for inclusion in Tier 2 in respect of exposures subject to internal ratings-based approach (prior to application of cap)		
E.8	Cap for inclusion of provisions in Tier 2 under internal ratings-based approach		

Completion Guidance

Item	Description	Guidance
A	**Common Equity Tier 1 Capital: instruments and reserves**	
A.1	Directly issued qualifying common share capital (and equivalent for non-joint stock companies) plus related stock surplus	Common share capital plus related share premium. Instruments in this classification must meet all of the criteria in ***Annex A***.
A.2	Retained earnings	Retained earnings from prior years, net of current year losses but only including auditor certified profits.
A.3	Accumulated other comprehensive income (and other reserves)	Enter the total of all other reserves that meet the CET1 qualifying criteria (as set out for A.1), net of any reduction in the current year but only including increases that are auditor certified.
A.4	Common share capital issued by subsidiaries and held by third parties (amount allowed in group CET1)	Data should only be entered by banks that own subsidiaries that have issued common share capital that is held by third parties, and only then in the case of prudential reporting submitted on a consolidated basis. The amount allowed is limited to the amount required to meet regulatory requirements in respect of CET1 capital.
A.5	**Common Equity Tier 1 capital before regulatory adjustments**	**Automatically completed, being the sum of A.1 to A.4**
A.6	**Less: Common Equity Tier 1 capital: regulatory adjustments**	

Item	Description	Guidance
A.7	Prudential valuation adjustments	Data should be entered if the bank holds any assets at fair value that are illiquid. Where applicable, banks should consider the guidance contained in section VIII, "Treatment for illiquid positions", of the Basel Committee paper titled "Revisions to the Basel II market risk framework", issued July 2009. It should be noted that this guidance applies adjustments to positions in the banking book.
A.8	Goodwill (net of related tax liability)	All goodwill should be shown here (net of any related deferred tax liability).
A.9	Other intangibles, other than mortgage-servicing rights (net of related tax liability)	All other intangibles (with the exception of mortgage servicing rights) should be shown here (net of any related deferred tax liability). See line A.20 for mortgage servicing rights.
A.10	Deferred tax assets that rely on future profitability excluding those arising from temporary differences (net of related tax liability)	Report all deferred tax assets ("DTAs") that rely on future profitability of the bank. For this purpose, DTAs may be netted with associated deferred tax liabilities ("DTLs") but only if the DTAs and DTLs relate to taxes levied by the same taxation authority and offsetting is permitted by that taxation authority. Where DTAs relate to temporary differences, the proposed amount to be deducted is set out in Item A.21 below.
A.11	Cash-flow hedge reserve	Report adjustments to the amount of the cash flow hedge reserve that relates to the hedging of items that are not fair valued on the balance sheet (including projected cash flows) and hence derecognised in the calculation of CET1 capital. This means that positive amounts should be deducted and negative amounts should be added back.
A.12	Shortfall of provisions to expected losses	This is only applicable to banks using advanced approaches. Enter the amount (if any) that expected losses, as calculated under IRB rules, exceed the stock of provisions. No adjustment can be made for any tax effects that could be expected to occur if provisions were to rise to the level of expected losses.
A.13	Securitisation gain on sale (as set out in paragraph 562 of Basel II framework)	This only applies to banks that issue securitised debt instruments. Report any increase in equity capital resulting from a securitisation transaction, such as that associated with expected future margin income.
A.14	Gains and losses due to changes in own credit risk on fair valued liabilities	Report gains or losses resulting from revaluation of own fair valued liabilities that arise due to own-credit related factors. This means that gains will be deducted and losses will be added back. This must include the part of a derivative valuation that relates to own-credit risk (referred to as a "debit valuation adjustment, or "DVA") including any DVA that arises on origination (to be included here and in addition reported separately in item A.14a).

Item	Description	Guidance
A.14a	*of which: amount relating to DVAs recognised on origination*	*Report the amount of DVAs that arose on origination (and include in the amount reported for Item A.14)*
A.15	Defined-benefit pension fund net assets	For each defined benefit pension fund that is an asset on the balance sheet, the asset should be reported here, net of any associated deferred tax liability which would be extinguished if the asset should become impaired or derecognised under the relevant accounting standards.
A.16	Investments in own shares (if not already netted off paid-in capital on reported balance sheet).	This is applicable only for banks that hold treasury shares. All of a bank's investments in its own common shares (treasury shares), whether held directly or indirectly, should be deducted here (unless already derecognised under the relevant accounting standards).
A.17	Reciprocal cross-holdings in common equity	Report reciprocal cross holdings in common equity issued by banking, financial and insurance entities.
A.18	Investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation, net of eligible short positions, where the bank does not own more than 10% of the issued common share capital of the entity (amount above 10% threshold)	This is only applicable for banks that have multiple non-significant (below 10% of the issuing entity's issued share capital) holdings of capital instruments issued by banking, financial and insurance entities. Report the amount by which the total of all such holdings exceeds 10% of total CET1. Where the holding is partly or wholly comprised of Tier 2 or AT1 instruments, report the amount by which total holdings exceed 10% of CET1 divided in the same proportions as the relevant holding (also see items B.9 and C.8).
A.19	Significant investments in the common stock of banking, financial and insurance entities that are outside the scope of regulatory consolidation, net of eligible short positions (amount above 10% threshold)	This is applicable where either:- • An individual holding is significant (CET1, AT1 and Tier 2 in the case of banks) - more than 10% of issuing entity's issued share capital; or • Where the holding is in the entity that is an associate, which includes all subsidiaries of the bank. In both cases, report the full amount of such holdings less an allowance of 10% of the bank's CET1 capital, after deductions (see A.22 regarding this allowance).

Item	Description	Guidance
A.20	Mortgage servicing rights (amount above 10% threshold)	This is only applicable where an intangible asset is held that arose in connection with providing mortgage servicing, typically in connection with the mortgage assets transferred to a securitisation vehicle. Report the full amount of all such assets less an allowance of 10% of CET1 capital, after deductions (see A.22 regarding this allowance).
A.21	Deferred tax assets arising from temporary differences (amount above 10% threshold, net of related tax liability)	This is applicable where deferred tax assets that do not rely on future profitability (see Item A.10). Report the full amount of all such assets less an allowance of 10% of CET1 capital, after deductions (see A.22 regarding this allowance).
A.22	Amount exceeding the 15% threshold	Report an amount equal to: • The sum of the exposures connected to items A.19, A.20 and A.21 that fall within the individual allowances (10% of CET1 capital, after deductions); less • An allowance of 15% of CET1 capital, after deductions. For example, if DTA were 21% and the other two items were 7% (mortgage servicing rights) and 5% significant investments, then the deductions required would be:- • 11% reported under A.21 (after applying the 10% allowance); and • 7% reported here under A.22 (being 10% plus 7% plus 5% less the 15% allowance). All exposures of this nature (A.19 to A.21) that are not deducted (here or in items A.19 to A.21) would be risk weighted at 250%.
A.23	*of which: significant investments in the common stock of financials*	*Items A.23, A.24 and A.25 should be used to provide a break-down of the amount reported in A.22 into three sub-components.*
A.24	*of which: mortgage servicing rights*	
A.25	*of which: deferred tax assets arising from temporary differences*	
A.26	National specific regulatory adjustments, including Pillar 2 deductions applied to CET1 capital	Report deductions required by the Commission as a result of the ICAAP / SREP.

Item	Description	Guidance
A.27	Regulatory adjustments applied to Common Equity Tier 1 due to insufficient Additional Tier 1 and Tier 2 to cover deductions	This is calculated automatically as being equal to the sum calculated for B.13a, **"of which: excess AT1 deductions"**. This corresponds to the amount of any deductions that would ordinarily be eligible to be deducted from lower quality capital but could not be, due to the deduction exceeding the amount of such capital.
A.28	**Total regulatory adjustments to Common Equity Tier 1**	**Automatically calculated as completed as the sum of A.7 to A.27 not including sub-category items A.14a, A.23, A.24 and A.25.**
A.29	**Common Equity Tier 1 capital (CET1)**	**Automatically calculated as A.5 minus A.28.**
B	**Additional Tier 1 capital: instruments**	
B.1	Directly issued qualifying Additional Tier 1 instruments plus related stock surplus	Report amounts of instruments meeting the qualifying criteria in ***Annex B*** that have been issued by the bank itself. Stock surplus (i.e. share premium) that is not eligible for inclusion in Common Equity Tier 1, will only be permitted to be included in Additional Tier 1 capital if the shares giving rise to the stock surplus are permitted to be included in Additional Tier 1 capital.
B.2	*of which: classified as equity under applicable accounting standards*	*B.2 and B.3 are used to report the breakdown of item B.1 into equity and liability items.*
B.3	*of which: classified as liabilities under applicable accounting standards*	
B.4	Additional Tier 1 instruments (and CET1 instruments not included in A.5) issued by subsidiaries and held by third parties (amount allowed in AT1)	This only applies in the case of prudential reporting submitted on a consolidated basis, where the bank owns a subsidiary that is itself a regulated bank that has issued:- • AT1 instruments that are held by third parties; or • Common share capital that is held by third parties but exceeds the amount eligible in item A.4 (i.e. the amount needed to meet regulatory requirements in respect of CET1 capital). The amount allowed is limited to the amount required to meet the subsidiary's regulatory requirements in respect of Tier 1 capital.

Item	Description	Guidance
B.5	**Additional Tier 1 capital before regulatory adjustments**	**Calculated automatically as the sum of B.1 and B.4 only.**
B.6	**Less: Additional Tier 1 capital: regulatory adjustments**	
B.7	Investments in own Additional Tier 1 instruments	Report any holdings of instruments issued, including any held through consolidated subsidiaries.
B.8	Reciprocal cross-holdings in Additional Tier 1 instruments	Report reciprocal cross holdings in AT1 instruments issued by banking, financial and insurance entities.
B.9	Investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation, net of eligible short positions, where the bank does not own more than 10% of the issued common share capital of the entity (amount above 10% threshold)	This is only applicable for banks that have multiple non-significant (below 10% of the issuing entity's issued share capital) holdings of AT1 capital instruments issued by banking, financial and insurance entities. Report the amount by which the total of all such holdings exceeds 10% of total CET1. Where the holding is a mix of CET1, AT1 and Tier 2 instruments, report the amount by which total holdings exceed 10% of CET1 divided in the same proportions as the relevant holding.
B.10	Significant investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation (net of eligible short positions)	This is applicable where either:- • An individual holding is significant (CET1, AT1 and Tier 2 in the case of banks) - more than 10% of issuing entity's issued share capital; or • Where the holding is in the entity that is an associate, which includes all subsidiaries of the bank. In both cases, report the full amount of such holdings.
B.11	National specific regulatory adjustments, including Pillar 2 deductions applied to Additional Tier 1 capital	Report deductions required by the Commission as a result of the ICAAP / SREP.

Item	Description	Guidance
B.12	Regulatory adjustments applied to Additional Tier 1 due to insufficient Tier 2 to cover deductions	This is calculated automatically as being equal to the sum calculated for C.11a, **"of which: excess Tier 2 deductions"**. This corresponds to the amount of any deductions that would ordinarily be eligible to be deducted from lower quality capital but could not be, due to the deduction exceeding the amount of such capital.
B.13	**Total regulatory adjustments to Additional Tier 1 capital**	**Automatically calculated, being the sum of B.7 to B.12**
B.13a	***Of which: excess AT1 deductions***	***Automatically calculated as B.13 minus B.5, subject to a minimum of zero***
B.14	**Additional Tier 1 capital ("AT1")**	**Automatically calculated as B.5 minus B.13, subject to a minimum of zero.**
B.15	**Tier 1 capital (T1 = CET1 + AT1)**	**Automatically calculated as A.29 plus B.14.**

Item	Description	Guidance
C	**Tier 2 Capital**	
C.1	Directly issued qualifying Tier 2 instruments plus related stock surplus	Report amounts of instruments meeting the qualifying criteria in ***Annex C*** that have been issued by the bank itself. Stock surplus (i.e. share premium) that is not eligible for inclusion in Tier 1, will only be permitted to be included in Tier 2 capital if the shares giving rise to the stock surplus are permitted to be included in Tier 2 capital.
C.2	Tier 2 instruments (and CET1 and AT1 instruments not included in items A.5 or B.5) issued by subsidiaries and held by third parties (amount allowed in group Tier 2)	This only applies to banks that report on a consolidated basis and own subsidiaries that have issued: • Tier 2 instruments that are held by third parties; or • Common share capital or AT1 instruments that are held by third parties but exceed the amount eligible in Items A.4/B.4 (i.e. the amount needed to meet regulatory requirements in respect of CET1 capital/AT1 capital). The amount allowed is limited to the amount required to meet the subsidiary's regulatory requirements in respect of total capital.

Item	Description	Guidance
C.3	Provisions	Report the amount of provisions allowed, subject to the following rules: *Standardised approach* Provisions or loan-loss reserves held against future, presently unidentified losses are freely available to meet losses which subsequently materialise and therefore qualify for inclusion within Tier 2. Provisions ascribed to the identified deterioration of particular assets or known liabilities, whether individual or grouped, should be excluded. Furthermore, general provisions/general loan-loss reserves eligible for inclusion in Tier 2 will be limited to a maximum of 1.25 percentage points of credit risk-weighted assets (in Form SR-2C) calculated under the standardised approach. *Internal ratings-based approach ("IRB Approach")* Where the total expected loss amount is less than total eligible provisions, as explained in para 380 to 383 of the June 2006 comprehensive version of Basel II, banks may recognise the difference in tier 2 capital up to a maximum of 0.6% of credit risk-weighted assets calculated under the IRB Approach.
C.4	**Tier 2 capital before regulatory adjustments**	**Automatically calculated as the sum of C.1 to C.3.**
C.5	**Less: Tier 2 capital: regulatory adjustments**	
C.6	Investments in own Tier 2 instruments	Report holdings of own Tier 2 instruments issued, including any held through consolidated subsidiaries.
C.7	Reciprocal cross-holdings in Tier 2 instruments	Report cross holdings in Tier 2 instruments issued by banking, financial and insurance entities.
C.8	Investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation, net of eligible short positions, where the bank does not own more than 10% of the issued common share capital of the entity (amount above the 10% threshold)	This is only applicable for banks that have multiple non-significant (below 10% of the issuing entity's issued share capital) holdings of Tier 2 capital instruments issued by banking, financial and insurance entities. Report the amount by which the total of all such holdings exceeds 10% of total CET1. Where the holding is a mix of CET1, AT1 and Tier 2 instruments, report the amount by which total holdings exceed 10% of CET1 divided in the same proportions as the relevant holding.

Item	Description	Guidance
C.9	Significant investments in the capital of banking, financial and insurance entities that are outside the scope of regulatory consolidation (net of eligible short positions)	This is applicable where either:- • An individual holding is significant (CET1, AT1 and Tier 2 combined in the case of banks) - more than 10% of issuing entity's issued share capital; or • Where the holding is in the entity that is an associate, which includes all subsidiaries of the bank. In both cases, report the full amount of such holdings.
C.10	National specific regulatory adjustments, including Pillar 2 deductions applied to Tier 2 capital	Report deductions required by the Commission as a result of the ICAAP / SREP.
C.11	**Total regulatory adjustments to Tier 2 capital**	**Automatically calculated, being the sum of C.6 to C.10**
C.11a	***Of which: excess Tier 2 deductions***	***Automatically calculated as C.11 minus C.4, subject to a minimum of zero***
C.12	**Tier 2 capital (T2)**	**Automatically calculated as C.4 minus C.11 subject to a minimum of zero**
D	**Total capital (TC = T1 + T2)**	**Automatically calculated as B.15 plus C.12**

E	Capital Memorandum Items	
Amounts below the threshold for deduction (before risk weighting)		
E.1	Non-significant investments in the capital of other financial institutions	Report non-significant investments in the capital of other financials, being the total amount of such holdings that are not reported in items A.18, B.9 and C.8.
E.2	Significant investments in the common stock of financial institutions	Report significant investments in the common stock of financials, being the total amount of such holdings that are not reported in items A.19 and A.23.
E.3	Mortgage servicing rights (net of related tax liability)	Report mortgage servicing rights, being the total amount of such holdings that are not reported in items A.20 and A.24.
E.4	Deferred tax assets arising from temporary differences (net of related tax liability)	Report deferred tax assets arising from temporary differences, being the total amount of such holdings that are not reported in items A.21 and A.25.
Applicable caps on the inclusion of provisions in Tier 2		

E.5	Provisions eligible for inclusion in Tier 2 in respect of exposures subject to standardised approach (prior to application of cap)	Report provisions eligible for inclusion in Tier 2, in respect of exposures subject to standardised approach, prior to the application of the cap (as relevant to C.3).
E.6	Cap on inclusion of provisions in Tier 2 under standardised approach	Report an amount equal to 1.25% of credit risk weighted assets (as reported in section A of Form SR-2C) calculated under the standardised approach.
E.7	Provisions eligible for inclusion in Tier 2 in respect of exposures subject to internal ratings-based approach (prior to application of cap)	Report provisions eligible for inclusion in Tier 2 in respect of exposures subject to internal ratings-based approach, prior to the application of the cap (as relevant to C.3).
E.8	Cap on inclusion of provisions in Tier 2 under internal ratings-based approach	Report an amount equal to 0.6% of credit risk weighted assets (as reported in section A of Form SR-2C) calculated under the internal ratings-based approach.

Annex A

Criteria for classification as common shares for regulatory capital purposes

1. Represents the most subordinated claim in liquidation of the bank.

2. Entitled to a claim on the residual assets that is proportional with its share of issued capital, after all senior claims have been repaid in liquidation (i.e. has an unlimited and variable claim, not a fixed or capped claim).

3. Principal is perpetual and never repaid outside of liquidation (setting aside discretionary repurchases or other means of effectively reducing capital in a discretionary manner that is allowable under relevant law).

4. The bank does nothing to create an expectation at issuance that the instrument will be bought back, redeemed or cancelled nor do the statutory or contractual terms provide any feature which might give rise to such an expectation.

5. Distributions are paid out of distributable items (retained earnings included). The level of distributions is not in any way tied or linked to the amount paid in at issuance and is not subject to a contractual cap (except to the extent that a bank is unable to pay distributions that exceed the level of distributable items).

6. There are no circumstances under which the distributions are obligatory. Non-payment is therefore not an event of default.

7. Distributions are paid only after all legal and contractual obligations have been met and payments on more senior capital instruments have been made. This means that there are no preferential distributions, including in respect of other elements classified as the highest quality issued capital.

8. It is the issued capital that takes the first and proportionately greatest share of any losses as they occur. Within the highest quality capital, each instrument absorbs losses on a going concern basis proportionately and pari passu with all the others.

9. The paid in amount is recognised as equity capital (i.e. not recognised as a liability) for determining balance sheet insolvency.

10. The paid in amount is classified as equity under the relevant accounting standards.
11. It is directly issued and paid-in and the bank cannot directly or indirectly have funded the purchase of the instrument.

12. The paid in amount is neither secured nor covered by a guarantee of the issuer or related entity or subject to any other arrangement that legally or economically enhances the seniority of the claim.

13. It is only issued with the approval of the owners of the issuing bank, either given directly by the owners or, if permitted by applicable law, given by the Board of Directors or by other persons duly authorised by the owners.

14. It is clearly and separately disclosed on the bank's balance sheet.

Annex B

Criteria for inclusion in Additional Tier 1 capital

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

1. Issued and paid-in.

2. Subordinated to depositors, general creditors and subordinated debt of the bank.

3. Is neither secured nor covered by a guarantee of the issuer or related entity or other arrangement that legally or economically enhances the seniority of the claim vis-à-vis bank creditors.

4. Is perpetual, i.e. there is no maturity date and there are no step-ups or other incentives to redeem.

5. May be callable at the initiative of the issuer only after a minimum of five years.
    a. To exercise a call option a bank must receive prior supervisory approval; and
    b. A bank must not do anything which creates an expectation that the call will be exercised; and
    c. Banks must not exercise a call unless:
        i. They replace the called instrument with capital of the same or better quality and the replacement of this capital is done at conditions which are sustainable for the income capacity of the bank[3]; or
        ii. The bank demonstrates that its capital position is well above the minimum capital requirements after the call option is exercised.[4]

6. Any repayment of principal (e.g. through repurchase or redemption) must be with prior supervisory approval and banks should not assume or create market expectations that supervisory approval will be given.

7. Dividend/coupon discretion:
    a. the bank must have full discretion at all times to cancel distributions/payments
    b. cancellation of discretionary payments must not be an event of default
    c. banks must have full access to cancelled payments to meet obligations as they fall due
    d. cancellation of distributions/payments must not impose restrictions on the bank except in relation to distributions to common stockholders.

8. Dividends/coupons must be paid out of distributable items.

9. The instrument cannot have a credit sensitive dividend feature, that is a dividend/coupon that is reset periodically based in whole or in part on the banking organisation's credit standing.

10. The instrument cannot contribute to liabilities exceeding assets if such a balance sheet test forms part of national insolvency law.

11. Instruments classified as liabilities for accounting purposes must have principal loss absorption through either (i) conversion to common shares at an objective pre-specified

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

[4] Minimum refers to the total minimum capital requirement prescribed by the Commission comprising Pillar 1 and Pillar 2.

trigger point or (ii) a write-down mechanism which allocates losses to the instrument at a pre-specified trigger point.

The write-down will have the following effects:

a. Reduce the claim of the instrument in liquidation;
b. Reduce the amount re-paid when a call is exercised; and
c. Partially or fully reduce coupon/dividend payments on the instrument.

The trigger point for write-down/conversion of loss absorbing instruments classified as liabilities must be at least the minimum for Common Equity Tier 1 capital (8.5% of RWAs).

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

The terms and conditions must have a provision that enables such instruments, at the option of the relevant authority, to either be written off or converted into common equity upon the occurrence of a trigger event, where:

- any compensation paid to the instrument holders as a result of the write-off must be paid immediately in the form of common stock (or its equivalent in the case of non-joint stock companies);
- the prior authorisation necessary to immediately issue the relevant number of shares specified in the instrument's terms and conditions should the trigger event occur; and
- the trigger event is the earlier of: (1) a decision that a write-off, without which the firm would become non-viable, is necessary, as determined by the relevant authority; and (2) the decision to make a public sector injection of capital, or equivalent support, without which the firm would have become non-viable, as determined by the relevant authority.

12. Neither the bank nor a related party over which the bank exercises control or significant influence can have purchased the instrument, nor can the bank directly or indirectly have funded the purchase of the instrument.

13. The instrument cannot have any features that hinder recapitalisation, such as provisions that require the issuer to compensate investors if a new instrument is issued at a lower price during a specified time frame.

14. If the instrument is not issued by the bank itself, proceeds must be immediately available without limitation to the bank in a form which meets or exceeds all of the other criteria for inclusion in Additional Tier 1 capital.

Annex C

Criteria for inclusion in Tier 2 Capital

1. Issued and paid-in.

2. Subordinated to depositors and general creditors of the bank.

3. Is neither secured nor covered by a guarantee of the issuer or related entity or other arrangement that legally or economically enhances the seniority of the claim vis-à-vis depositors and general bank creditors.
4. Maturity:
   a. minimum original maturity of at least five years
   b. recognition in regulatory capital in the remaining five years before maturity will be amortised on a straight line basis
   c. there are no step-ups or other incentives to redeem

5. May be callable at the initiative of the issuer only after a minimum of five years:
   a. To exercise a call option a bank must receive prior supervisory approval;
   b. A bank must not do anything that creates an expectation that the call will be exercised[5]; and
   c. Banks must not exercise a call unless:
      i. They replace the called instrument with capital of the same or better quality and the replacement of this capital is done at conditions which are sustainable for the income capacity of the bank[6]; or
      ii. The bank demonstrates that its capital position is well above the minimum capital requirements after the call option is exercised.

6. The investor must have no rights to accelerate the repayment of future scheduled payments (coupon or principal), except in bankruptcy and liquidation.

7. The instrument cannot have a credit sensitive dividend feature, that is a dividend/coupon that is reset periodically based in whole or in part on the banking organisation's credit standing.

8. Neither the bank nor a related party over which the bank exercises control or significant influence can have purchased the instrument, nor can the bank directly or indirectly have funded the purchase of the instrument. For example, if the instrument is held by a holding company, any lending to the holding company by the bank (directly or indirectly) will result in an amount equal to that lending becoming ineligible.

9. If the instrument is not issued by the bank itself, proceeds must be immediately available without limitation to the bank in a form which meets or exceeds all of the other criteria for inclusion in Tier 2 Capital.

10. The terms and conditions must have a provision that enables such instruments, at the option of the relevant authority, to either be written off or converted into common equity upon the occurrence of a trigger event, where:

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

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

- Any compensation paid to the instrument holders as a result of the write-off must be paid immediately in the form of common stock (or its equivalent in the case of non-joint stock companies).
- The prior authorisation necessary to immediately issue the relevant number of shares specified in the instrument's terms and conditions should the trigger event occur.

For this purpose, a trigger event is the earlier of: (1) a decision that a write-off, without which the firm would become non-viable, is necessary, as determined by the relevant authority; (2) the decision to make a public sector injection of capital, or equivalent support, without which the firm would have become non-viable, as determined by the relevant authority; or (3) minimum Common Equity Tier 1 capital is significantly below the level required in order to continue to operate, which for these purposes is defined at 50% of the minimum level required (4.25% of RWAs).

APPENDIX 2 – REPORTING FORM AND COMPLETION GUIDANCE – MINOR CHANGES TO RISK WEIGHTED ASSETS

Reporting Form

FORM SR-1B (extract only): revised portfolio K

Item	Nature of Item	Amount £'000	Amount after CRM £'000	Risk Weight	Risk Weighted Amount £'000
J	**Past Due Exposures**				
J.1	Secured				
J.1.1	Risk Weight 0%			0	0
J.1.2	Risk Weight 20%			20	0
J.1.3	Risk Weight 35%			35	0
J.1.4	Risk Weight 50%			50	0
J.1.5	Risk Weight 75%			75	0
J.1.6	Risk Weight 100%			100	0
J.1.7	Risk Weight 150%			150	0
J.2	Unsecured				
J.2.1	Risk Weight 50%			50	0
J.2.2	Risk Weight 100%			100	0
J.2.3	Risk Weight 150%			150	0
	SUBTOTAL	**0**	**0**		**0**
K	**250% and 1250% risk weighted items (NEW)**				
K.1	250% risk weighted items				
K.1.1	Significant investments in the common stock of banking, financial and insurance entities			250	0
K.1.2	Mortgage servicing rights			250	0
K.1.3	Deferred tax assets arising from temporary differences			250	0
	SUB TOTAL	**0**	**0**		**0**
K.2	1250% risk weighted items				
K.2.1	Securitisations - Equity Tranches			1,250	0
K.2.2	Significant investments in commercial entities			1,250	0
	SUBTOTAL	**0**	**0**		**0**
L	**Other Balance Sheet Exposures**				
L.1	Tangible Assets			100	0
L.2	Equity			100	0
L.3	High Risk Assets			150	0
L.4	Other, including Prepayments and Debtors				
L.4.1	Risk Weight 0%			0	0
L.4.2	Risk Weight 20%			20	0
L.4.3	Risk Weight 35%			35	0
L.4.4	Risk Weight 50%			50	0
L.4.5	Risk Weight 75%			75	0
L.4.6	Risk Weight 100%			100	0
L.4.7	Risk Weight 150%			150	0
	SUBTOTAL	**0**	**0**		**0**

Completion Guidance

The guidance below is for the new section K of Form SR-1B only.

Item	Description	Guidance
K.1	**250% risk weighted assets**	
K.1.1	Significant investments in the common stock of banking, financial and insurance entities	Only amounts excluded from deduction (i.e. below the threshold) under items A.19 and A.22 (re A.23) of Form SR-2A should be reported here. A 250% risk weighting applies.
K.1.2	Mortgage servicing rights	Only amounts excluded from deduction (i.e. below the threshold) under items A.20 and A.22 (re A.24) of Form SR-2A should be reported here. A 250% risk weighting applies.
K.1.3	Deferred Tax Assets arising from temporary differences	Only amounts excluded from deduction (i.e. below the threshold) under items A.21 and A.22 (re A.25) of Form SR-2A should be reported here. A 250% risk weighting applies.
	SUBTOTAL	**Total for "K.1: 250% risk weighted assets", calculated by the sheet as the sum of K.1.1 to K.1.3.**
K.2	**1,250% risk weighted assets**	
K.2.1	Securitisations - equity tranches	Includes all first loss tranches. Also include tranches rated below BB-, including those with short term ratings of lower than A-3 (or equivalent - see tables 3 & 4 of the prudential returns guidance to credit risk for the standardised approach re Form SR-1B). A 1,250% risk weighting applies (note: the current guidance in tables 3 and 4 refer to a capital deduction).
K.2.2	Significant investments in commercial entities	The proportion of significant (minority and/or majority) investments in commercial entities exceeding the following materiality levels: (a) 15% of the bank's capital for individual investments in commercial entities; and (b) 60% of the bank's capital for the aggregate of such investments. A 1,250% risk weighting applies. The amount below materiality thresholds should be reported under item L.2 of Form SR-1B (as equity).
	SUBTOTAL	**Total for "K.2: 1,250% risk weighted assets", calculated by the sheet as the sum of K.2.1 to K.2.2.**

APPENDIX 3 – REPORTING FORM AND COMPLETION GUIDANCE – CAPITAL RATIOS

Reporting Form

FORM SR-2C (extract): CAPITAL RATIOS

		Amount £'000	
A	**CREDIT RISK**		
A.1	Credit Risk - RWA Equivalent: SSA		*insert from SR-1B summary*
A.2	Credit Risk - RWA Equivalent: SAC		*insert from SR-1B summary*
A.3	Credit Risk - RWA Equivalent: FIRB		
A.4	Credit Risk - RWA Equivalent: AIRB		
	TOTAL CREDIT RISK RWA	**0**	
B	**OPERATIONAL RISK**		
B.1	Operational Risk - RWA Equivalent: BIA		*linked from SR-1C*
B.2	Operational Risk - RWA Equivalent: SAO		*linked from SR-1C*
B.3	Operational Risk - RWA Equivalent: ASA		*linked from SR-1C*
B.4	Operational Risk - RWA Equivalent: AMA		
	TOTAL OPERATIONAL RISK RWA	**0**	
C	**MARKET RISK IN THE BANKING BOOK**		
C.1	Market Risk - RWA Equivalent - SAM: FX & Gold		*linked from SR-4*
C.2	Market Risk - RWA Equivalent - SAM: Commodities		*linked from SR-4*
	TOTAL BANKING BOOK MARKET RISK RWA	**0**	
D	**TOTAL SETTLEMENT RISK RWA**		*linked from SR-4*
E	**TOTAL RISK WEIGHTED ASSETS (Pillar 1)**	**0**	
E.1	*of which: 250% risk weighted assets*	0	*linked from SR-1B, section K.1*
E.2	*of which: 1250% risk weighted assets*	0	*linked from SR-1B, section K.2*

F	**CAPITAL RATIOS**	**Actual ratios**	**Bank specific minima**	**National minima**
F.1	CET1 ratio (as a % of risk weighted assets)	**#DIV/0!**		8.50
F.2	Tier 1 ratio (as a % of risk weighted assets)	**#DIV/0!**		8.50
F.3	Total capital ratio (as a % of risk weighted assets)	**#DIV/0!**		10.00
F.4	Bank specific buffer (as a % of risk weighted assets)			11.00

		Amount £'000
F.5	Eligible (total) capital required to support Pillar 1 risks	**0**
F.6	Eligible (total) capital required to support Pillar 2 risks (pre buffer)	**0**
F.7	Eligible (total) capital required to support notification level (inclusive of any capital planning buffer)	**0**
F.8	Total eligible capital required (to meet bank specific notification level)	**0**
F.9	Surplus total eligible capital	**0**

Completion Guidance

The guidance for section A to D shown below is identical to current guidance in force. Only the guidance covering sections E and F is new.

Item	Description	Guidance
A	**Credit Risk**	
A.1	Credit Risk - RWA Equivalent: SSA	If the bank uses SSA for credit risk then record the total RWA reported for the bank, as calculated by Form SR-1B.
A.2	Credit Risk - RWA Equivalent: SAC	If the bank uses SAC for credit risk then record the total RWA reported for the bank, as calculated by Form SR-1B.
A.3	Credit Risk - RWA Equivalent: FIRB	If the bank uses FIRB for credit risk then record the total RWA calculated for the bank using that approach.
A.4	Credit Risk - RWA Equivalent: AIRB	If the bank uses AIRB for credit risk then record the total RWA calculated for the bank using that approach.
	TOTAL CREDIT RISK RWA	**Calculated by the sheet, being the sum of A.1 to A.4 (for banks using the SSA or SAC this will equal the amount reported under that approach only)**
B	**Operational Risk**	
B.1	Operational Risk - RWA Equivalent: BIA	If the bank uses BIA for operational risk then record the total RWA equivalent reported for the bank, as calculated by form SR-1C. ***This line will be automatically generated from SR-1C.***
B.2	Operational Risk - RWA Equivalent: SAO	If the bank uses SAO for operational risk then record the total RWA equivalent reported for the bank, as calculated by form SR-1C. ***This line will be automatically generated from SR-1C.***
B.3	Operational Risk - RWA Equivalent: ASA	If the bank uses ASA for operational risk then record the total RWA equivalent reported for the bank, as calculated by form SR-1C. ***This line will be automatically generated from SR-1C.***
B.4	Operational Risk - RWA Equivalent: AMA	If the bank uses AMA for operational risk then record the total RWA equivalent calculated for the bank using that approach.
	TOTAL OPERATIONAL RISK RWA	**Calculated by the sheet, being the sum of B.1 to B.4 (normally equivalent to only one of the above lines).**
C	**Market Risk in the Banking Book**	
C.1	Market Risk - RWA Equivalent - SAM: FX & Gold	If the bank uses SAM for market risk then record the total RWA equivalent reported for these exposures, as calculated by form SR-4 in the section on "Foreign Currency Exposure". ***This line will be automatically generated from SR-4.***

Item	Description	Guidance
C.2	Market Risk - RWA Equivalent - SAM: Commodities	If the bank uses SAM for market risk then record the total RWA equivalent reported for commodities, as calculated by form SR-4 in the section on "Commodity Risk". ***This line will be automatically generated from SR-4.***
	TOTAL BANKING BOOK MARKET RISK RWA	**Calculated by the sheet, being the sum of C.1 and C.2.**
D	**TOTAL SETTLEMENT RISK RWA**	If the bank uses SAM for market risk then record the total RWA equivalent reported for these exposures, as calculated by form SR-4 in the section on "Settlement Risk". ***This line will be automatically generated from SR-4.***
E	**TOTAL RISK WEIGHTED ASSETS (Pillar 1)**	**Calculated by the sheet, being the sum of the totals of A to D above.**
E.1	*Of which: 250% risk weighted assets*	*This line will be automatically generated from SR-1B portfolio K.1.*
E.2	*Of which: 1,250% risk weighted assets*	*This line will be automatically generated from SR-1B portfolio K.2*
F	**Capital Ratios**	
F.1	CET1 ratio (as a % of risk weighted assets)	*Actual ratio* Calculated automatically, being the amount of CET1 capital as reported in line A.29 of SR-2A divided by the RWAs in E above. *Bank specific minima* Enter the minimum CET1 ratio required for the bank, as established by the Commission as a result of the Pillar 2 process (ICAAP and SREP). The figure should be entered as a number only (e.g. if the prescribed minimum is 9% it should be entered as "9"). *National minima* This is fixed at 8.5%.

Item	Description	Guidance
F.2	Tier 1 ratio (as a % of risk weighted assets)	*Actual ratio* Calculated automatically, being the amount of Tier 1 capital as reported in line B.15 of SR-2A divided by the RWAs in E above. *Bank specific minima* Enter the minimum Tier 1 ratio required for the bank, as established by the Commission as a result of the Pillar 2 process (ICAAP and SREP). The figure should be entered as a number only (e.g. if the prescribed minimum is 9% it should be entered as "9"). *National minima* This is fixed at 8.5%.
F.3	Total capital ratio (as a % of risk weighted assets)	*Actual ratio* Calculated automatically, being the amount of Total capital as reported in line D of SR-2A divided by the RWAs in E above. *Bank specific minima* Enter the minimum total capital ratio required for the bank, as established by the Commission as a result of the Pillar 2 process (ICAAP and SREP). The figure should be entered as a number only (e.g. if the prescribed minimum is 10.5% it should be entered as "10.5"). *National minima* This is fixed at 10%.
F.4	Bank specific buffer (as a % of risk weighted assets)	*Bank specific minima* Enter the total capital ratio notification level (inclusive of any capital planning buffer) required for the bank, as established by the Commission as a result of the Pillar 2 process (ICAAP and SREP). This may be set at the standard 1% figure above the bank specific minima. The figure should be entered as a number only (e.g. if the prescribed notification level is 13% it should be entered as "13"). *National minima* The minimum notification requirement for all banks is set at 1% above the national minima for total capital (i.e. 11%).

Item	Description	Guidance
F.5	Eligible (total) capital required to support Pillar 1 risks	Calculated by the sheet, being 10% of the total risk weighted assets reported in E above.
F.6	Eligible (total) capital required to support Pillar 2 risks (pre buffer)	Calculated by the sheet, being the agreed bank specific minimum total capital ratio reported in F.3 multiplied by the total risk weighted assets reported in E, less the amount reported in F.5 covering pillar 1 risks.
F.7	Eligible (total) capital required to support notification level (inclusive of any capital planning buffer)	Calculated by the sheet, being the agreed bank specific buffer (notification) total capital ratio reported in F.4 multiplied by the total risk weighted assets reported in E, less the amounts reported in F.5 covering pillar 1 risks and F.6 covering pillar 2 risks.
F.8	Total eligible capital required (to meet bank specific notification level)	Calculated by the sheet, being the sum of the capital amounts reported in F.5 to F.7. (This should also equate to line E multiplied by the bank specific ratio in line F.4).
F.9	Surplus (total) eligible capital	Calculated by the sheet being the total amount of capital available shown in line D of Form SR-2A less the total required capital as reported in F.8 above.

APPENDIX 4 – REPORTING FORM AND COMPLETION GUIDANCE – LEVERAGE RATIO

Reporting Form

FORM SR-2D: LEVERAGE RATIO

A	**On-balance sheet exposures**	**Amount £'000**	
A.1	On-balance sheet items (exclude derivatives and SFTs; include collateral)		
A.2	Less: assets deducted in determining Basel III Tier 1 capital		
A.3	**Total on-balance sheet exposures (excluding derivatives and SFTs)**	**0**	
B	**Derivative exposures**		
B.1	Replacement cost (net of eligible cash variation margin)		
B.2	Add-on amount		
B.3	Gross up for derivatives collateral provided		
B.4	Less: deductions of receivables assets for cash variation margin provided in derivatives transactions		
B.5	Less: exempted CCP leg of client-cleared trade exposures		
B.6	Gross notional credit derivatives sold		
B.7	Less: Notional offsets and add-on deductions for written credit derivatives)		
B.8	**Total derivative exposures**	**0**	
C	**Securities financing transaction exposures**		
C.1	Gross SFT assets (with no recognition of accounting netting), after adjusting for sale accounting transactions		
C.2	Netted amounts of cash payables and cash receivables of gross SFT assets		
C.3	SFT counterparty exposure		
C.4	Agent transaction exposures		
C.5	**Total securities financing transaction exposures**	**0**	
D	**Other off-balance sheet exposures**		
D.1	Off-balance sheet exposure at gross notional amount		
D.2	Less: adjustments for conversion to credit equivalent amount		
D.3	**Total other off-balance sheet exposures**	**0**	
E	**Capital and Total Exposures**		
E.1	**Tier 1 Capital (end of reporting period value)**	**0**	*automatically generated from line B.15 of Form SR-2A*
E.2	**Total exposures (end of reporting period value**	**0**	
F	**LEVERAGE RATIO**	**#DIV/0!**	

Completion Guidance

Glossary

The following abbreviations are used within the document:

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

Leverage ratio calculation

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

Detailed guidance

Item	Description	Guidance
A	**On-balance sheet exposures**	
A.1	On-balance sheet items (exclude derivatives and SFTs; include collateral)	Report all on-balance sheet assets including on-balance sheet derivative collateral and collateral for securities financing transactions ("SFTs")[7] (but excluding on-balance sheet derivative and SFT assets which are addressed further below).
A.2	Less: Assets deducted in determining Basel III Tier 1 capital	Report on-balance sheet assets deducted from Tier 1 capital. To ensure consistency, on-balance sheet assets deducted from Tier 1 capital (as set out in items A.8 to A.27 and items B.7 to B.12 of form SR-2A) should be included here. It should be noted that liability items (e.g. gains and losses due to changes in own credit risk on fair valued liabilities) should not be included.
A.3	**Total on-balance sheet exposures (excluding derivatives and SFTs)**	**The figure is automatically calculated as being A.1 minus A.2**
B	**Derivative exposures**	

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

Item	Description	Guidance
B.1	Replacement cost (net of eligible cash variation margin)	Report the bank's Replacement Cost ("**RC**") for all of its derivatives exposures, including where credit derivatives. This should be equivalent to the "Positive Mark-to-Market" element of the Credit Equivalent Amount as calculated under the Standardised Approach to Credit Risk. Note: collateral received may not be netted against derivatives exposures whether or not netting is permitted under the bank's operative accounting or risk-based framework. When calculating the exposure amount a bank must not reduce the exposure amount by any collateral received from the counterparty. Furthermore, the RC must be grossed up by any collateral amount used to reduce its value, including when collateral received by a bank has reduced the derivatives assets reported on-balance sheet under its operative accounting framework. However, where an eligible bilateral netting contract is in place, as described in ***Annex 1*** below, then the **RC** for the set of derivative exposures covered by the contract will be the net replacement cost. *Cash variation margin received* - In the case of cash variation margin received, if the conditions listed under guidance for Item B.4 are met, the receiving bank may reduce the RC of the exposure amount of the derivative asset by the amount of cash received if the RC of the derivative contract(s) has not already been reduced by the same amount of cash variation margin received under the bank's operative accounting standard.
B.2	Add-on amount	Report the add-on for Potential Future Exposure ("**PFE**"). This should be equivalent to the "Add-on Amount" element of the Credit Equivalent Amount as calculated under the Standardised Approach to Credit Risk. Where an eligible bilateral netting contract is in place, as described in the Annex below, then the add-on for the set of derivative exposures covered by the contract will be A_{Net} as described in ***Annex 1***. Note - cash variation margin may not be used to reduce the PFE amount.
B.3	Gross up for derivatives collateral provided	Report the amount of any derivatives collateral provided where the provision of that collateral has reduced the value of their balance sheet assets under their operative accounting framework.

Item	Description	Guidance
B.4	Less: deductions of receivables assets for cash variation margin provided in derivatives transactions	Report adjustments permitted regarding the treatment of cash variation margin. In the treatment of derivative exposures for the purpose of the leverage ratio, the cash portion of variation margin exchanged between counterparties may be viewed as a form of pre-settlement payment (and hence not as collateral), if the following conditions are met: (i) For trades not cleared through a qualifying central counterparty (QCCP)[8] the cash received by the recipient counterparty is not segregated. (ii) Variation margin is calculated and exchanged on a daily basis based on mark-to-market valuation of derivatives positions. (iii) The cash variation margin is received in the same currency as the currency of settlement of the derivative contract. (iv) Variation margin exchanged is the full amount that would be necessary to fully extinguish the mark-to-market exposure of the derivative subject to the threshold and minimum transfer amounts applicable to the counterparty. (v) Derivatives transactions and variation margins are covered by a single master netting agreement (MNA) between the legal entities that are the counterparties in the derivatives transaction. The MNA must explicitly stipulate that the counterparties agree to settle net any payment obligations covered by such a netting agreement, taking into account any variation margin received or provided if a credit event occurs involving either counterparty. The MNA must be legally enforceable and effective in all relevant jurisdictions, including in the event of default and bankruptcy or insolvency. If these conditions are met, the cash portion of variation margin may be used to reduce the RC reported in B.1. Further, In the case of cash variation margin provided to a counterparty, the posting bank may report the resulting receivable in this line, where the cash variation margin has been recognised as an asset under the bank's operative accounting framework.

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

Item	Description	Guidance
B.5	Less: exempted CCP leg of client-cleared trade exposures	Report certain deductions relating to the treatment of clearing services. Where a bank acting as clearing member (CM)[9] offers clearing services to clients, the clearing member's trade exposures to the central counterparty (CCP) that arise when the clearing member is obligated to reimburse the client for any losses suffered due to changes in the value of its transactions in the event that the CCP defaults, must be captured by applying the same treatment that applies to any other type of derivatives transactions. However, if the clearing member, based on the contractual arrangements with the client, is not obligated to reimburse the client for any losses suffered due to changes in the value of its transactions in the event that a QCCP defaults, the clearing member need not recognise the resulting trade exposures to the QCCP in the leverage ratio exposure measure. Hence it should include the exposure in Items B.1 and B.2 but enter an offsetting negative amount in Item B.5. *Note* - Where a client enters directly into a derivatives transaction with the CCP and the CM guarantees the performance of its clients' derivative trade exposures to the CCP, the bank acting as the clearing member for the client to the CCP must calculate its related leverage ratio exposure resulting from the guarantee as a derivative exposure, as if it had entered directly into the transaction with the client, including with regard to the receipt or provision of cash variation margin, and include the amounts within Items B.1 to B.4.
B.6	Gross notional credit derivatives sold	Report the full effective notional value[10] referenced by a written credit derivative. This amount is in addition to any exposure amount reported in relation to the same derivative in Items B.1, B.2 and B.3 and represents the credit exposure arising from the credit worthiness of the reference entity.

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

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

Item	Description	Guidance
B.7	Less: notional offsets and add-on deductions for written credit derivatives	Report an amount determined as the sum of: (i) The effective notional amounts which may be reduced by purchased credit protection. The effective notional amount of a written credit derivative may be reduced by the effective notional amount of a purchased credit derivative on the same reference name provided: • the credit protection purchased is on a reference obligation which ranks pari passu with, or is junior to, the underlying reference obligation of the written credit derivative in the case of single name credit derivatives; and • the remaining maturity of the credit protection purchased is equal to or greater than the remaining maturity of the written credit derivative. (ii) The effective notional amounts, which may be reduced by any negative change in fair value amount that has been incorporated into the calculation of Tier 1 capital with respect to the written credit derivative; and (iii) The individual add-on amount relating to a written credit derivative (not offset by eligible purchased credit protection) reported under Item B.2.
B.8	**Total derivative exposures**	**The figure is automatically calculated as being the sum of B.1 to B.3, plus B.6, minus B.4, B.5 and B.7.**
C	**Securities financing transaction (SFT) exposures**	
C.1	Gross SFT assets (with no recognition of accounting netting), after adjusting for sale accounting transactions	Report gross SFT assets recognised for accounting purposes (i.e. with no recognition of accounting netting) , adjusted to exclude the value of securities received in an SFT where the bank has recognised the securities as an asset on its balance sheet (e.g. under IFRS or US GAAP).

Item	Description	Guidance
C.2	Netted amounts of cash payables and cash receivables of gross SFT assets	Report gross SFTs cash payables and cash receivables in SFTs with the same counterparty measured net, if all the following criteria are met: a) Transactions have the same explicit final settlement date; b) The right to set off the amount owed to the counterparty with the amount owed by the counterparty is legally enforceable both currently in the normal course of business and in the event of: (i) default; (ii) insolvency; and (iii) bankruptcy; and c) The counterparties intend to settle net, settle simultaneously, or the transactions are subject to a settlement mechanism that results in the functional equivalent of net settlement, that is, the cash flows of the transactions are equivalent, in effect, to a single net amount on the settlement date. To achieve such equivalence, both transactions are settled through the same settlement system and the settlement arrangements are supported by cash and/or intraday credit facilities intended to ensure that settlement of both transactions will occur by the end of the business day and the linkages to collateral flows do not result in the unwinding of net cash settlement.

Item	Description	Guidance
C.3	SFT counterparty exposure	This item is used to report a measure of counterparty credit risk as current exposure, to be calculated as follows: • Where no qualifying MNA is in place, the current exposure (E*) for transactions with a counterparty must be calculated on a transaction by transaction basis: that is, each transaction is treated as its own netting set, as shown in the following formula: $E^* = \max \{0, [(E) - (C)]\}$ where E is the total fair value of securities and cash lent and C is the total fair value of cash and securities received under the transaction. • Where a qualifying MNA is in place (***see Annex 2***) the current exposure (E*) is the greater of zero and the total fair value of securities and cash lent to a counterparty for all transactions included in the qualifying MNA (Σ(E)) less the total fair value of cash and securities received from the counterparty for those transactions (Σ(C)). This is illustrated in the following formula: $E^* = \max \{0, [\Sigma(E) - \Sigma(C)]\}$
C.4	Agent transaction exposures	Report exposures arising where a bank acts as an agent in an SFT and provides a guarantee to a customer or counterparty for any difference between the value of the security or cash the customer has lent and the value of collateral the borrower has provided. This exposure should be calculated using the same methodology as that used for Item C.3.
C.5	**Total securities financing transaction exposures**	Automatically completed as the sum of Items C.1 to C.4.
D	**Other off-balance sheet exposures**	
D.1	Off-balance sheet exposure at gross notional amount	Report total off-balance sheet ("OBS") exposure on a gross notional basis, before any adjustment for credit conversation factors according to D.2.
D.2	Less: adjustments for conversion to credit equivalent amount	Report an amount representing the reduction in gross amount of OBS exposures due to the application of credit conversion factors ("CCFs"). The CCFs are those that apply under the Standardised Approach to Credit Risk except that they are subject to a floor of 10%.
D.3	**Other off-balance sheet exposures**	**The figure is automatically calculated as D.1 minus D.2**
E	**Capital and Total Exposures**	

Item	Description	Guidance
E.1	**Tier 1 capital (end of reporting period value)**	**Used to report Tier 1 capital. The figure is automatically calculated from Item B.15 in Form SR-2A**
E.2	**Total Exposures (end of reporting period value)**	**Automatically calculated as the sum of A.3, B.8, C.5 and D.3**
F	**Leverage Ratio**	**Automatically calculated as E.1 divided by E.2 with the ratio expressed as a percentage.**

Annex 1

Bilateral netting

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

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

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

    c) In both cases (a) and (b), a bank will need to satisfy the Commission that it has:

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

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

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

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

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

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

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

   where:

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

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

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

Annex 2

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

a) provide the non-defaulting party with the right to terminate and close out in a timely manner all transactions under the agreement upon an event of default, including in the event of insolvency or bankruptcy of the counterparty;
b) provide for the netting of gains and losses on transactions (including the value of any collateral) terminated and closed out under it so that a single net amount is owed by one party to the other;
c) allow for the prompt liquidation or setoff of collateral upon the event of default; and
d) be, together with the rights arising from provisions required in (a) and (c) above, legally enforceable in each relevant jurisdiction upon the occurrence of an event of default regardless of the counterparty's insolvency or bankruptcy.

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

a) All transactions are marked to market daily, and
b) The collateral instruments used in the transactions are recognised as eligible financial collateral in the banking book.

APPENDIX 5 – PROPOSED CHANGES TO RULES (BY TRACKED CHANGES)

Rule 2.23: Capital Resources

1. A licenceholder must by its directors —
   a. establish and maintain an internal capital adequacy assessment process (ICAAP) which is appropriate to the nature and scale of its business, and
   b. review that process annually.

2. A licenceholder must not at any time permit its CET1 ratio, Tier 1 ratio, or Total capital ratio ~~risk-asset ratio~~ to fall below the minimum capital~~risk-asset ratio~~ requirements as set out in Rule 2.23(6).

3. A licenceholder must immediately notify the Commission if at any time it has reason to believe that its CET1 ratio, Tier 1 ratio or Total capital ratio~~risk-asset ratio~~ -
   a. is below the minimum capital requirements as set out in Rule 2.23(6)~~risk-asset ratio~~;
   b. is within 1% of the minimum ~~risk-asset ratio~~capital requirement (for the Total capital ratio only). For example, where a licenceholder has a minimum ~~risk-asset ratio~~Total capital ratio of 10~~8~~%, it must notify the Commission if its ~~risk-asset ratio~~Total capital ratio is 11~~9~~% or lower.

4. A licenceholder must by its directors —
   a. maintain appropriate procedures and controls for the purpose of monitoring its compliance with the requirements of paragraph (3), and
   b. review those procedures annually.

5. A licenceholder must provide the Commission with details of -
   a. its ICAAP;
   b. the procedures referred to in paragraph (4)(a); and
   c. any substantial amendment of it or them,

within 20 business days of the approval by the directors of the process, procedures or amendment.

6. In this rule, in relation to a licenceholder, "minimum capital requirement~~risk-asset ratio~~" means —
   a. such CET1 ratio, Tier 1 ratio and Total capital ratio~~risk-asset ratio~~ as the Commission may direct in the case of that licenceholder; or
   b. where no such direction is given, a CET ratio of 8.5%, a Tier 1 ratio of 8.5% and a Total capital ratio of 10%~~8%~~.

Rule 2.25(1): Contents of annual financial return

1. A licenceholder's annual financial return must include (in addition to the annual financial statements mentioned in rule 2.9(2)(a)) -
   ~~a. a statement detailing the calculation of its large exposures capital base as at its annual reporting date;~~

   a. a detailed profit and loss account relating to its own transactions (if not included in the annual financial statements); and
   b. a statement providing a reconciliation of all material differences between -

      i. the set of deposit taking returns as at its annual reporting date, and
      ii. the balance sheet and profit and loss account.

Rule 8.36(3): Large exposure management

3. A licenceholder must—
   a. notify the Commission before entering into an exempt exposure, except—
      i. an exposure falling within either or both rule 8.38(a) or 8.38(b); or
      ii. an exposure which requires the Commission's consent under rule 8.36(2A); or
      iii. where the Commission has directed that the exposure need not be notified;
   b. notify the Commission immediately when the total of its large exposures, excluding exempt exposures, exceeds or is likely to exceed 300% of its LECB;
   c. notify the Commission immediately of any breach of—
      i. the limit in paragraph (1)(a) or (b), or
      ii. any other counterparty limit agreed with the Commission for the purpose of this sub-paragraph;
   d. ~~notify the Commission immediately if its adjusted capital base falls below its current LECB~~.

Appendix 1 – interpretation (relevant extracts only in relation to capital and large exposures)

~~adjusted capital base (“ACB”)~~	~~in relation to a licenceholder, means a measurement of its capital available to cover its risk-weighted assets, calculated in accordance with rule 2.24 or 2.28;~~
CET1 ratio	in relation to a licenceholder, means a ratio of its Common Equity Tier 1 capital available to cover its risk weighted assets, calculated in accordance with rule 2.2.4 or 2.28;
deposit taking return	means a return required by rule 2.24 or 2.28;
internal capital adequacy assessment process ("ICAAP")	in relation to a licenceholder, means procedures for assessing the adequacy of its capital and financial resources;
large exposure	in relation to a licenceholder, means any exposure which is 10% or more of the licenceholder’s large exposures capital base;
large exposures capital base ("LECB")	in relation to a licenceholder, means its Tier 1 capital (calculated in accordance with rule 2.24 or 2.28);~~the adjusted capital base calculated annually on the licenceholder’s latest audited financial statements;~~
large exposures policy statement	means a statement of a bank’s policy on treatment of large exposures;
quarter	for Class 1 licenceholders, means a period ending on a quarter-end; and for all other licenceholders, means a three month period based on the licenceholder’s accounting year end;
quarter-end	means 31st March, 30th June, 30th September or 31st December;
risk-asset ratio (“RAR”)	means a ratio of adjusted capital base to risk-weighted assets;
risk-weighted assets	means assets weighted by risk (calculated in accordance with rule 2.24 or 2.28);
set of deposit taking returns	means a set of returns required by rule 2.24 or 2.28;
Tier 1 ratio	in relation to a licenceholder, means a ratio of its common Tier 1 capital available to cover its risk weighted assets, calculated in accordance with rule 2.2.4 or 2.28;
Total capital ratio	in relation to a licenceholder, means a ratio of its Total capital available to cover its risk weighted assets, calculated in accordance with rule 2.2.4 or 2.28;