UE

NATIONAL BANK OF MOLDOVA

D E C I S I O N
on the approval of the Regulation on the treatment of counterparty credit risk for banks

No 102 of 16.04.2020
(in force as of 01.01.2021)

Official Monitor of the Republic of Moldova No 118-123 Art. 464 of 22.05.2020

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REGISTERED:
by the Ministry of Justice
of the Republic of Moldova
No 1563 of May 8, 2020

Pursuant to Article 27 paragraph (1) point c), Article 44 point a) of the Law no.548/1995 on the National Bank of Moldova (republished in the Official Monitor of the Republic of Moldova, 2015, no.297-300, Art.544), with subsequent amendments, Article 60 paragraph (4) and Article 73 paragraph (1) of the Law No 202/2017 on the activity of banks (Official Monitor of the Republic of Moldova, 2017, No .434-439, Art.727), the Executive Board of the National Bank of Moldova

DECIDES:

1. To approve the Regulation on the treatment of counterparty credit risk for banks (attached).
2. This Decision shall be published in the Official Monitor of the Republic of Moldova and shall enter into force from 01.01.2021.

CHAIRMAN
OF THE EXECUTIVE BOARD **Octavian ARMAŞU**

No 102. Chişinău, April 16, 2020.

Approved
by the Decision of the Executive Board
of the National Bank of Moldova
No 102 of April 16, 2020

REGULATION
on the treatment of counterparty credit risk for banks

This Regulation transposes Art.4 (1), point.34; Art.271; Art.272, point.2-6, 12, 24-26; Art.273 (1), (3)-(8); Art.274-282; Art.291; Art.295-299; Art.300 (2) and (3); Art.305 of Regulation (EU) No.575/2013 of the European Parliament and of the Council of June 26, 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No.648 /2012 (Text with EEA relevance), published in the Official Journal of the European Union No L 176 of June 27, 2013, as last amended by Commission Delegated Regulation (EU) 2015/62 of October 10, 2014.

Chapter I
GENERAL PROVISIONS

Section 1
Scope and Definitions

1. This Regulation sets out the methodologies for determining the own funds requirements to hedge counterparty credit risk, namely:

1) rules on the treatment of counterparty credit risk for derivatives, long settlement transactions;

2) the principles that banks will follow when calculating the risk-weighted exposure amounts for counterparty risk of items in the trading book.

2. This Regulation shall apply to banks headquartered in the Republic of Moldova, as well as to branches in the Republic of Moldova of banks from other states, which are licensed by the National Bank of Moldova, hereinafter referred to as banks.

3. For the purposes of this Regulation the following terms shall be used:

contractual cross product netting agreement - a bilateral contractual agreement between an institution and a counterparty which creates a single legal obligation (based on netting of covered transactions) covering all bilateral master agreements and transactions belonging to different product categories that are included within the agreement;

counterparty - any legal or natural person that enters into a netting agreement, and has the contractual capacity to do so;

central counterparty (CCP) - a legal person that interposes itself between counterparties to contracts traded on one or more financial markets, becoming the buyer to every seller and the seller to every buyer;

clearing - the process of establishing positions, including the calculation of net obligations, and ensuring the availability of financial instruments, cash or both to secure exposures arising from those positions;

delta - the expected variation in the price of a financial instrument in relation to a change in the price of the underlying instrument of the financial instrument;

clearing member - a legal person which participates in a CCP and which is responsible for discharging the financial obligations arising from that participation;

risk position - a risk number that is assigned to a transaction under the standardized method set out in Chapter V, Section 4 following a predetermined algorithm;

general wrong-way risk - arises when the likelihood of default by counterparties is positively correlated with general market risk factors;

specific wrong-way risk - occurs when future exposure to a specific counterparty is positively correlated with the counterparty's probability of default due to the nature of the transactions with the counterparty. A bank shall be considered to be exposed to specific wrong-way risk if the future exposure to a specific counterparty is expected to be high when the counterparty's probability of a default is also high;

hedging set - means a group of risk positions arising from the transactions within a single netting set, where only the balance of those risk positions is used for determining the exposure value under the standardized method set out in chapter 5, section 4 of this Regulation;

netting set - a group of transactions between a bank and a single counterparty that is subject to a legally enforceable bilateral netting agreement that is recognized under Chapter VI of this Regulation and Chapters III and VI of the Regulation on credit risk mitigation techniques used by banks, approved by the Executive Board (HCE) Decision No 112/2018. Any transaction that is not the subject of a legally enforceable contractual netting arrangement recognized in accordance with Chapter VI of Regulation No 112/2018 shall be treated as a netting set itself for the purposes of this Regulation;

payment leg - the payment agreed in an OTC derivative transaction with a linear risk profile which stipulates the exchange of a financial instrument for a payment. In the case of transactions that stipulate the exchange of payment against payment, those two payment legs shall consist of the contractually agreed gross payments, including the notional amount of the transaction;

long settlement transactions - transactions where a counterparty undertakes to deliver a security, a commodity, or a foreign exchange amount against cash, other financial instruments, or commodities, or vice versa, at a settlement or delivery date specified by contract that is later than the market standard for this particular type of transaction or 5 business days after the date on which the bank enters into the transaction, whichever is earlier;

margin lending transactions - transactions in which an institution extends credit in connection with the purchase, sale, carrying or trading of securities. Margin lending transactions do not include other loans that are secured by collateral in the form of securities;

current market value (CMV) - for the purposes of chapter 5 of this Regulation refers to the net market value of the portfolio of transactions within a netting set, where both positive and negative market values are used in computing the CMV;

Chapter II
DETERMINATION OF THE EXPOSURE VALUE

4. The bank shall be entitled to determine the exposure value of repurchase transactions, securities or commodities lending or borrowing transactions, long settlement transactions and margin lending transactions in accordance with this Regulation without using the provisions of Regulation No 112/2018 on credit risk mitigation techniques used by banks.

5. For the purposes of assessing the counterparty credit risk, the exposure value of derivatives and transactions referred to in point 4 shall be determined using the following calculation methods:

1) Mark-to-Market Method;

2) Original Exposure Method;

3) Standardized Method.

6. The bank shall determine the exposure value for the contracts referred to in Annex no.1 to Regulation No 114/2018 on the treatment of market risk under the standardized approach, based on one of the methods set out in Chapters III-V and in accordance with this Chapter.

7. The bank shall not use the Original Exposure Method set out in Chapter IV in the following situations:

1) if the bank is not eligible for the treatment set out in paragraphs 135-137 of the Regulation on banks' own funds and capital requirements, approved by HCE No 109/2018;

2) in order to determine the exposure value for the contracts listed in point 3 of Annex1 of Regulation No 114/2018 on the treatment of market risk under the standardized approach.

8. Banks may use the methods set out in Chapters III-V in combination, on a permanent basis, within a group as defined in the Law No 250/2017 on the supplementary supervision of banks, insurers/reinsurers, and investment firms belonging to a financial conglomerate.

9. The bank must not use the methods set out in Chapters III to V in combination on a permanent basis, but it may use the methods set out in Chapters III to V in combination, unless one of the methods is used for the situations referred to in point 48.

10. If the bank acquires protection by means of a credit derivative to hedge a non-trading book exposure or a counterparty credit risk exposure, it may calculate the own funds requirement for hedged exposure in accordance with Chapter IX of Regulation No 112/2018 on credit risk mitigation techniques used by banks. The counterparty credit exposure value for these credit derivatives shall be zero unless the bank applies the approach set out in point 76 subpoint (2).

11. By way of derogation from point 10, the bank may choose consistently to include for the purposes of calculating own funds requirements for counterparty credit risk all credit derivatives not included in the trading book and purchased as protection against a non-trading book exposure or against a counterparty credit risk exposure where the credit protection is recognized under Regulation No 112/2018 on credit risk mitigation techniques and this Regulation.

12. Where credit default swaps sold by the bank are treated by a bank as credit protection provided by that institution and are subject to own funds requirement for credit risk of the underlying for the full notional amount, their exposure value for the purposes of CCR in the non-trading book shall be zero.

13. Under all methods set out in Chapters III to V, the exposure value for a given counterparty shall be equal to the sum of the exposure values calculated for each netting set with that counterparty.

14. For a given counterparty, the exposure value for a given netting set of OTC derivative instruments listed in Annex 1 to Regulation No 114/2018 on the treatment of market risk under the standardized method, calculated in accordance with this Regulation, shall be the greater of zero and the difference between the sum of exposure values across all netting sets with the counterparty and the sum of CVA for that counterparty being recognized by the bank as an incurred write-down. The credit valuation adjustments, in accordance with paragraph 3 of the Regulation on the treatment of credit valuation adjustment risk for banks, shall be calculated without taking into account any offsetting debit valuation adjustment attributed to the bank's own credit risk that has been already excluded from own funds pursuant to paragraph 26 (3) of the Regulation No 109/2018 on banks' own funds and capital requirements.

15. Banks shall determine the exposures value for exposures arising from long settlement transactions using any of the methods set out in Chapters III-V, regardless of which the bank has chosen for treating OTC derivatives and repurchase transactions, securities or commodities lending or borrowing transactions and margin lending transactions.

16. For the methods set out in Chapters III and IV, the bank shall adopt a consistent methodology for determining the notional amount for different product types and shall ensure that the notional amount to be taken into account provides an appropriate measure of the risk inherent in the contract. Where the contract provides for a multiplication of cash flows, the notional amount shall be adjusted by the bank to take into account the effects of the multiplication on the risk structure of that contract.

17. For the methods set out in chapters III-V, banks shall treat transactions where specific wrong way risk has been identified in accordance with the following provisions, as appropriate:

1) the bank must give appropriate consideration to exposures that give rise to a significant level of specific and general wrong-way risk;

2) the bank shall maintain procedures to identify, monitor and control cases of specific wrong-way risk for each legal entity, beginning at the inception of a transaction and continuing throughout the life of the transaction;

3) banks shall calculate the own funds requirements for counterparty credit risk in relation to transactions where specific wrong-way risks have been identified and where there exists a legal connection between the counterparty and the issuer of the instrument underlying the OTC derivative or repurchase transaction, securities or commodities lending or borrowing transaction, margin lending transaction, in accordance with the following principles:

a) the instruments where specific wrong-way risk exists shall not be included in the same netting set as other transactions with the counterparty and shall each be treated as a separate netting set;

b) within any such separate netting set, the exposure value for single-name credit default swaps (a contract that provides protection against default by a single issuer - single signature) equals the full expected loss in the value of the remaining fair value of the underlying instruments based on the assumption that the underlying issuer is in liquidation;

c) the applicable risk weight shall be that of an unsecured transaction, in accordance with the provisions of point 73 of the Regulation on the treatment of credit risk for banks according to the standardized method, approved by HCE No 111/2018;

d) for all other transactions (other than those indicated in letter b) referencing a single name in any such separate netting set, the calculation of the exposure value shall be consistent taking into account the assumption of a sudden jump-to-default of those underlying obligations where the issuer is legally connected with the counterparty. For transactions referencing a basket of names or index, the jump-to-default of the respective underlying obligations, if significant, applies, where there is a legal link between the issuer and the counterparty;

4) the responsible subdivisions of the bank shall provide the executive body and the competent committee of the bank with regular reports on the specific risk, as well as the general wrong-way risk and the measures taken to manage this risk.

18. Banks shall report counterparty credit risk exposure in accordance with the requirements set out in the Instruction on the submission by banks of COREP reports for supervisory purposes, approved by HCE No 117/2018.

CHAPTER III
MARKET-TO-MARKET METHOD

19. Under the mark-to-market method, the exposure value is the sum of the current replacement cost and the exposure from potential future loans.

20. In order to determine the current replacement cost of all contracts with positive values, banks shall attach the current market values to the contracts.

21. In order to determine the potential future credit exposure, banks shall multiply the notional amounts or underlying values, as applicable, by the percentages in Table 1 and in accordance with the following principles:

1) contracts which do not fall within one of the five categories indicated in Table 1 shall be treated as contracts concerning commodities other than precious metals;

2) for contracts with multiple exchanges of principal, the percentages shall be multiplied by the number of remaining payments still to be made in accordance with the contract;

3) for contracts that are structured to settle outstanding exposure following specified payment dates and where the terms are reset so that the market value of the contract is zero on those specified dates, the residual maturity shall be equal to the time until the next reset date. In the case of interest-rate contracts that meet those criteria and have a remaining maturity of over one year, the percentage shall be no lower than 0,5 %.

Table 1

Residual maturity	**Interest-rate contracts**	**Contracts concerning foreign-exchange rates and gold**	**Contracts concerning equities**	**Contracts concerning precious metals except gold**	**Contracts concerning commodities other than precious metals**
One year or less	0 %	1 %	6 %	7 %	10 %
Over one year, not exceeding five years	0,5 %	5 %	8 %	7 %	12 %
Over five years	1,5 %	7,5 %	10 %	8 %	15 %

22. For contracts relating to commodities other than gold, which are referred to in point 3 of Annex I of Regulation No 114/2018 on the treatment of market risk under the standardized method, as an alternative to applying the percentages in Table 1, the bank may apply the percentages in Table 2, provided that the bank follows the extended maturity ladder approach set out in points 157 and 158 of Regulation No 114/2018 on the treatment of market risk under the standardized method.

Table 2

Residual maturity	**Precious metals (except gold)**	**Base metals**	**Agricultural products (softs)**	**Other, including energy products**
One year or less	2 %	2,5 %	3 %	4 %
Over one year, not exceeding five years	5 %	4 %	5 %	6 %
Over five years	7,5 %	8 %	9 %	10 %

Chapter IV
ORIGINAL EXPOSURE METHOD

23. The exposure value is the notional amount of each instrument multiplied by the percentages set out in Table 3.

Table 3

Original maturity	Interest-rate contracts	Contracts concerning foreign-exchange rates and gold
One year or less	0,5 %	2 %
Over one year, not exceeding two years	1 %	5 %
Additional allowance for each additional year	1 %	3 %

24. For calculating the exposure value of interest-rate contracts, the bank may choose to use either the original or residual maturity.

CHAPTER V
STANDARDIZED METHOD

Section 1
Standardized method

25. When applying the SM, banks shall calculate the exposure value separately for each netting set, net of collateral, as follows:

Exposure value

$$\text{Valoarea expunerii} = \beta \cdot \max\left\{\text{CMV} - \text{CMC}, \sum_j \left|\sum_i \text{RPT}_{ij} - \sum_l \text{RPC}_{lj}\right| \cdot \text{CCRM}_j\right\}$$

where:
β = 1,4;
CMV = current market value of the portfolio of transactions within the netting set with a counterparty gross of collateral, where:

$$\text{CMV} = \sum_i \text{CMV}_i$$

where:
CMV_i = the current market value of transaction *i*;
CMC = the current market value of the collateral assigned to the netting set, where:

$$\text{CMC} = \sum_l \text{CMC}_l$$

where:

CMC_l = the current market value of transaction *l*;

i = index designating transaction;

l = index designating collateral;

j = index designating hedging set category.

The hedging sets for this purpose correspond to risk factors for which risk positions of opposite sign can be offset to yield a net risk position on which the exposure measure is then based;

RPT_{ij} = risk position from transaction *i* with respect to hedging set *j*;

RPC_{lj} = risk position from collateral *l* with respect to hedging set *j*;

$CCRM_j$ = CCR Multiplier set out in Table 5 with respect to hedging set *j*.

26. For the purposes of the calculation under point 25:

1) eligible collateral received from a counterparty shall have a positive sign and collateral posted to a counterparty shall have a negative sign;

2) only collateral that is eligible under chapter III section 3 and 4 of Regulation No 112/2018 on the credit risk mitigation techniques used by banks and point 72 of this Regulation shall be used under the standardized method;

3) the bank may disregard the interest rate risk from payment legs with a remaining maturity of less than one year;

4) the bank may treat transactions that consist of two payment legs that are denominated in the same currency as a single aggregate transaction. The treatment for payment legs applies to the aggregate transaction.

Section 2

Transactions with a linear risk profile

27. Transactions with linear risk profile are transactions whose outcome varies largely linearly. Banks shall match transactions with a linear risk profile to risk positions in accordance with the following provisions:

1) transactions with a linear risk profile with equities (including equity indices), gold, other precious metals or other commodities as the underlying shall be mapped to a risk position in the respective equity (or equity index) or commodity and an interest rate risk position for the payment leg;;

2) transactions with a linear risk profile with a debt instrument as the underlying instrument shall be mapped to an interest rate risk position for the debt instrument and another interest rate risk position for the payment leg;

3) transactions with a linear risk profile that stipulate the exchange of payment against payment, including foreign exchange forwards, shall be mapped to an interest rate risk position for each of the payment legs.

28. Where, under a transaction mentioned in point 27, a payment leg or the underlying debt instrument is denominated in foreign currency, that payment leg or underlying instrument shall also be mapped to a risk position in that currency.

29. The size of a risk position from a transaction with linear risk profile shall be the effective notional value (market price multiplied by quantity) of the underlying financial instruments or commodities converted into Moldovan lei by multiplication with the relevant exchange rate, except for debt instruments.

30. For debt instruments and for payment legs, the size of the risk position shall be the effective notional value of the outstanding gross payments (including the notional amount) converted into Moldovan lei and multiplied by the modified duration of the debt instrument or payment leg, as the case may be.

31. The size of a risk position from a credit default swap shall be the notional value of the reference debt instrument multiplied by the remaining maturity of the credit default swap.

Section 3

Transactions with a non-linear risk profile

32. The size of a risk position from an OTC derivative with a non-linear risk profile, including options and swaptions, of which the underlying is not a debt instrument, or a payment leg shall be equal to the delta equivalent effective notional value of the financial instrument that underlies the transaction in accordance with point 35 paragraph 1 letter b).

33. The size of a risk position from an OTC derivative with a non-linear risk profile, including options and swaptions, of which the underlying is a debt instrument or a payment leg, shall be equal to the delta equivalent effective notional value of the financial instrument or payment leg multiplied by the modified duration of the debt instrument or payment leg, as the case may be.

Section 4

Treatment of Collateral and calculation of risk positions

34. For the determination of risk positions, banks shall treat collateral as follows:

1) collateral received from a counterparty shall be treated as a claim on the counterparty under a derivative contract (long position) that is due on the day the determination is made;

2) collateral it has posted with the counterparty shall be treated as an obligation to the counterparty (short position) that is due on the day the determination is made.

35. The bank shall determine the size and sign of a risk position as follows:

1) for all instruments other than debt instruments:

a) as the effective notional value in the case of a transaction with a linear risk profile;

b) as the delta equivalent notional value, $P_{ref} \times \frac{\partial V}{\partial p}$, in the case of a transaction with a non-linear risk profile,

where:

P_{ref} = price of the underlying instrument, expressed in the reference currency;

V = value of the financial instrument (in the case of an option, the value is the option price);

p = price of the underlying instrument, expressed in the same currency as V;

If V is denominated in a currency other than the reference currency, the derivative shall be converted into the reference currency by multiplication with the relevant exchange rate agreed by the parties;

2) for debt instruments and the payment legs of all transactions:

a) as the effective notional value multiplied by the modified duration in the case of a transaction with a linear risk profile;

b) as the delta equivalent in notional value $P_{ref} \times \frac{\partial V}{\partial p}$ multiplied by the modified duration, $\frac{\partial V}{\partial r}$, in the case of a transaction with a non-linear risk profile, where:

P_{ref} = price of the underlying instrument, expressed in the reference currency;

p = price of the underlying instrument, expressed in the same currency as V;

V = value of the financial instrument (in the case of an option, the value is the option price);

r = interest rate level.

If V is denominated in a currency other than the reference currency, the derivative shall be converted into the reference currency by multiplication with the relevant exchange rate.

36. The banks shall group the risk positions into hedging sets. The absolute value amount of the sum of the resulting risk positions shall be calculated for each hedging set. The net risk position shall be the result of that calculation and shall be calculated for the purposes of point 25, as follows:

$$\left|\sum_{i} RPT_{ij} - \sum_{l} RPC_{lj}\right|$$

37. For interest rate risk positions arising from money deposits received from the counterparty as collateral, from payment legs and from underlying debt instruments and to which, in each case, a capital charge of 1.60% or less applies in accordance with Table 2 of point 58 of Regulation No 114/2018 on the treatment of market risk under the standardized method, there are six hedging sets for each currency, set out in Table 4.

Table 4

	Government referenced interest rates	**Non-government referenced interest rates**
Maturity	< 1 year	< 1 year
	>1 ≤ 5 years	>1 ≤ 5 years
	> 5 years	> 5 years

38. For interest rate risk positions from underlying debt instruments or payment legs for which the interest rate is linked to a reference interest rate that represents a general market interest level, the remaining maturity shall be the length of the time interval up to the next re-adjustment of the interest rate. In all other cases, it shall be the remaining life of the underlying debt instrument or, in the case of a payment leg, the remaining life of the transaction.

Section 5
Risk hedging sets

39. There shall be one hedging set for each issuer of a reference debt instrument that underlies a credit default swap.

40. N-th to default basket credit default swaps (credit default swaps that are linked to a basket of obligations with several reference obligations) shall be treated as follows:

1) the size of a risk position in a reference debt instrument in a basket underlying an n-th to default credit default swap shall be the effective notional value of the reference debt instrument, multiplied by the modified duration of the n-th to default derivative with respect to a change in the credit spread of the reference debt instrument;

2) there shall be one hedging set for each reference debt instrument in a basket underlying a given ·nth to default· credit default swap. Risk positions from different n-th to default credit default swaps shall not be included in the same hedging set;

3) the CCR multiplier applicable to each hedging set created for one of the reference debt instruments of an n-th to default derivative shall be as follows:

4) 0.3% for reference debt instruments that have a credit assessment from an external credit assessment institution (ECAI) recognized in accordance with the provisions of Annex No 3 to Regulation No 111/2018 on the treatment of credit risk for banks under the standardized method, equivalent to credit quality step 1 to 3 of the standardized method.

5) 0,6% for other debt instruments.

41. There is a hedging set per issuer for interest rate risk positions arising from:

1) money deposits that are posted with a counterparty as collateral when that counterparty does not have debt obligations of low specific risk outstanding;

2) Underlying debt instruments, to which a capital charge of more than 1.60% applies in accordance with Table 2 of paragraph 58 of Regulation No 114/2018 on the treatment of market risk under the standardized method.

42. When a payment leg emulates such a debt instrument indicated in point 41 subpoint (2), there shall also be one hedging set for each issuer of the reference debt instrument.

43. The bank may assign risk positions that arise from debt instruments of a particular issuer, or from reference debt instruments of the same issuer that are emulated by payment legs, or that underlie a credit default swap, to the same hedging set.

44. Underlying financial instruments other than debt instruments shall be assigned to the same hedging sets only if they are identical or similar instruments. In all other cases they shall be assigned to separate hedging sets.

45. For the purposes of point 44 banks shall determine whether underlying instruments are similar in accordance with the following principles:

1) for equities, the underlying is similar if it is issued by the same issuer. An equity index shall be treated as a separate issuer;

2) for precious metals, the underlying is similar if it is the same metal. A precious metal index shall be treated as a separate precious metal;

3) for electric power, the underlying is similar if the delivery rights and obligations refer to the same peak or off-peak load time interval within any 24-hour interval;

4) for commodities, the underlying is similar if it is the same commodity. A commodity index shall be treated as a separate commodity.

46. The CCR multipliers (hereinafter referred to as CCRM) for the different hedging set categories are set out in the following table:

Table 5

	Hedging set categories	**CCRM**
1.	Interest rates	0,2 %
2.	Interest Rates for risk positions from a reference debt instrument that underlies a credit default swap and to which a capital charge of 1,60 %, or less, applies under Table 2 point 58 of Regulation No 114/2018 on the treatment of market risk under the standardized method.	0,3 %
3.	Interest Rates for risk positions from a debt instrument or reference debt instrument to which a capital charge of more than 1,60 % applies under Table 2 point 58 of Regulation No 114/2018 on the treatment of market risk under the standardized method.	0,6 %
4.	Exchange Rates	2,5 %
5.	Electric Power	4 %
6.	Gold	5 %
7.	Equity	7 %
8.	Precious Metals (other than gold)	8,5 %

9.	Other Commodities (excluding precious metals and electricity power)	10 %
10.	Underlying instruments of OTC derivatives that are not in any of the above categories	10 %

47. Underlying instruments of OTC derivatives, as referred to in point 10 of Table 5, shall be assigned to separate individual hedging sets for each category of underlying instrument.

48. For transactions with a non-linear risk profile or for payment legs and transactions with debt instruments as underlying for which the bank cannot determine the delta or the modified duration, as the case may be, using a model approved in the context of paragraph 41 of Regulation 114/2018 on the treatment of market risk under the standardized approach, for the purposes of calculating own funds requirements for market risk, the National Bank of Moldova shall either determine the size of the risk positions and the applicable CCRMjs conservatively, or require the bank to use the method set out in Chapter III. Netting shall not be recognized (that is, the exposure value shall be determined as if there were a netting set that comprises just an individual transaction).

49. The bank shall have internal procedures to verify that, prior to including a transaction in a hedging set, the transaction is covered by a legally enforceable netting contract that meets the requirements set out in chapter VI.

50. The bank that makes use of collateral to mitigate its CCR shall have internal procedures to verify that, prior to recognizing the effect of collateral in its calculations, the collateral meets the legal certainty standards set out in Chapter VI of Regulation No 112/2018 on credit risk mitigation techniques used by banks.

Chapter VI
CONTRACTUAL NETTING

Section 1
Recognition of contractual netting as risk-reducing

51. Banks shall only treat the following types of contractual netting arrangements as risk-mitigating in accordance with Section 4 of this Chapter where the netting arrangement has been recognized by the National Bank of Moldova in accordance with Section 2 of this Chapter and the bank meets the requirements set out in Section 3 of this Chapter:

1) bilateral contracts for novation between an institution and its counterparty under which mutual claims and obligations are automatically amalgamated in such a way that the novation fixes one single net amount each time it applies so as to create a single new contract that replaces all former contracts and all obligations between parties pursuant to those contracts and is binding on the parties;

2) other bilateral agreements (other than those indicated in subpoint 1) between an institution and its counterparty.

52. Netting across transactions entered into by different legal entities of a group shall not be recognized for the purposes of calculating the own funds requirements.

Section 2
Recognition of contractual netting agreements

53. All contractual netting arrangements used by the bank to determine the exposure value under this Part must meet the following conditions:

1) the bank has concluded a contractual netting agreement with its counterparty which creates a single legal obligation, covering all included transactions, such that, in the event of default by the

counterparty it would be entitled to receive or obliged to pay only the net sum of the positive and negative mark-to-market values of included individual transactions;

2) the bank has made available to the competent authorities written and reasoned legal opinions to the effect that, in the event of a legal challenge of the netting agreement, the institution's claims and obligations would not exceed those referred to subpoint 1).

The legal opinion shall refer to the applicable law:

a) the jurisdiction in which the counterparty is incorporated;

b) if a branch of an undertaking is involved, which is located in a country other than that where the undertaking is incorporated, the jurisdiction in which the branch is located;

c) the jurisdiction whose law governs the individual transactions included in the netting agreement;

d) the jurisdiction whose law governs any contract or agreement necessary to effect the contractual netting;

3) credit risk to each counterparty is aggregated to arrive at a single legal exposure across transactions with each counterparty. This aggregation shall be factored into credit limit purposes and internal capital purposes;

4) the contract shall not contain any clause which, in the event of default of a counterparty, permits a non-defaulting counterparty to make limited payments only, or no payments at all, to the estate of the defaulting party, even if the defaulting party is a net creditor.

54. If the National Bank of Moldova, in the supervision process, is not satisfied that the contractual netting is legally valid and enforceable under the law of each of the jurisdictions referred to in point 53 subpoint (2), the contractual netting agreement shall not be recognized as risk-reducing for either of the counterparties.

Section 3

Obligations of banks

55. The bank shall establish and maintain procedures to ensure that the legal validity and enforceability of its contractual netting is reviewed in the light of changes in the law of relevant jurisdictions referred to in point 53 subpoint 2.

56. The bank shall maintain all required documentation relating to its contractual netting in its files.

57. The bank shall factor the effects of netting into its measurement of each counterparty's aggregate credit risk exposure and the institution shall manage its CCR on the basis of those effects of that measurement.

Section 4

Effects of recognition of netting as risk-reducing

58. The following treatment applies to contractual netting agreements:

1) netting for the purposes of Chapter V shall be recognized as set out in this Chapter;

2) for the purposes of Chapters III and IV, netting shall be recognized as follows:

a) in the case of netting agreements referred to in point 51 subpoint (1), the provisions of points 60 to 61 shall apply;

b) in the case of netting agreements referred to in point 51 subpoint (2), the provisions of paragraphs 62 to 66 shall apply.

59. In the case of contracts for novation, the single net amounts fixed by such contracts rather than the gross amounts involved, may be weighted.

60. In the application of Chapter III, banks may take the contract for novation into account when determining:

1) the current replacement cost referred to in points 20;

2) the notional principal amounts or underlying values referred to in point 21.

61. In the application of Chapter IV, in determining the notional amount referred to in point 23, banks may take into account the contract for novation for the purposes of calculating the notional principal amount. In such cases, banks shall apply the percentages of Table 3..

62. In the case of other netting agreements referred to in point 51 subpoint 2), banks shall apply Chapter III as follows:

1) the current replacement cost referred to in point 20 for the contracts included in a netting agreement shall be obtained by taking account of the actual hypothetical net replacement cost which results from the agreement. In the case where netting leads to a net obligation for the bank calculating the net replacement cost, the current replacement cost is calculated as 0;;

2) the figure for potential future credit exposure referred to in point 21, for all contracts included in a netting agreement shall be reduced in accordance with the following formula:

$$PCE_{red} = 0,4 \cdot PCE_{gross} + 0,6 \cdot NGR \cdot PCE_{gross}$$

where:

PCE_{red} = the reduced figure for potential future credit exposure for all contracts with a given counterparty included in a legally valid bilateral netting agreement;

PCE_{gross} = the sum of the figures for potential future credit exposure for all contracts with a given counterparty which are included in a legally valid bilateral netting agreement and are calculated by multiplying their notional principal amounts by the percentages set out in Table 1;

NGR = the net-to-gross ratio calculated as the quotient of the net replacement cost for all contracts included in a legally valid bilateral netting agreement with a given counterparty (numerator) and the gross replacement cost for all contracts included in a legally valid bilateral netting agreement with that counterparty (denominator).

63. When carrying out the calculation of the potential future credit exposure in accordance with the formula set out in point 62 subpoint 2), the banks may treat perfectly matching contracts included in the netting agreement as if they were a single contract with a notional principal equivalent to the net receipts.

64. In the case of the other netting agreements referred to in point 51 subpoint (2), in applying point 23, banks shall treat the contracts included in the netting agreement that match as a single contract with a notional principal that is equivalent to the net receipts, multiplying the notional principal amounts by the percentages indicated in Table 3.

65. For the purposes of point 63 and 64, perfectly matching contracts are forward foreign-exchange contracts or similar contracts in which a notional principal is equivalent to cash flows if the cash flows fall due on the same value date and fully in the same currency.

66. For all other contracts included in a netting agreement, the percentages applicable may be reduced as indicated in Table 6:

Table 6

Original maturity	Interest-rate contracts	Foreign-exchange contracts
One year or less	0,35 %	1,50 %
More than one year but not more than two years	0,75 %	3,75 %
Additional allowance for each additional year	0,75 %	2,25 %

Chapter VII
ITEMS IN THE TRADING BOOK

67. When calculating risk-weighted exposure amounts for counterparty risk of the items in the trading book, banks shall comply with the rules described in points 68 to 76.

68. In the case of total return swap credit derivatives and credit default swap credit derivatives, to obtain a figure for potential future credit exposure under the method set out in Chapter III of this Regulation, the nominal amount of the instrument shall be multiplied by the following percentages:

1) 5%, where the reference obligation is one that, if it gave rise to a direct exposure of the institution, would be a qualifying item within the meaning of Chapter III of Regulation No 114/2018 on the treatment of market risk under the standardized method;

2) 10%, where the reference obligation is one that, if it gave rise to a direct exposure of the institution, would not be a qualifying item within the meaning of Chapter III of Regulation No 114/2018 on the treatment of market risk under the standardized method.

69. In the case of the bank whose exposure arising from a credit default swap represents a long position in the underlying, the percentage for potential future credit exposure may be 0 %, unless the credit default swap is subject to close-out upon the insolvency of the entity whose exposure arising from the swap represents a short position in the underlying, even though the underlying has not defaulted.

70. Where the credit derivative provides protection in relation to nth to default amongst a number of underlying obligations, the bank shall determine which of the percentage figures set out in paragraph 68 shall apply by reference to the obligation with the nth lowest credit quality which, if incurred by the institution, would be a qualifying item for the purposes of Chapter III of Regulation No 114/2018 on the treatment of market risk under the standardized method.

71. In order to recognize the effects of the financial collateral, banks do not use the Financial Collateral Simple Method set out in Chapter VIII, Section 4 of Regulation No 112/2018 on credit risk mitigation techniques used by banks.

72. In the case of repurchase transactions and securities or commodities lending or borrowing transactions booked in the trading book, banks may recognize as eligible collateral all financial instruments and commodities that are eligible to be included in the trading book.

73. For exposures arising from OTC derivative instruments booked in the trading book, institutions may recognize commodities that are eligible to be included in the trading book as eligible collateral;

74. For the purposes of calculating volatility adjustments where such financial instruments or commodities which are not eligible under the Regulation No 112/2018 on credit risk mitigation techniques used by banks, sold or provided, or borrowed, purchased or received by way of collateral or otherwise under such a transaction, and the bank uses, in accordance with Chapter VIII of the nominated Regulation, the Supervisory volatility adjustments approach, such instruments and commodities shall be treated in the same way as non-main index equities listed on a recognized exchange;

75. In relation to the recognition of master netting agreements covering repurchase transactions, securities or commodities lending or borrowing transactions, or other capital market-driven transactions, banks shall only recognize netting across positions in the trading book and the non-trading book when the netted transactions fulfil the following conditions:

1) all transactions are marked to market daily;

2) any items borrowed, purchased, or received under the transactions may be recognized as eligible financial collateral under point 25 of Regulation No 112/2018 on credit risk mitigation techniques used by banks, without the application of point 72.

76. Where a credit derivative included in the trading book forms part of an internal hedge and the credit protection is recognized under this Regulation in accordance with Chapter V of Regulation No 112/2018 on credit risk mitigation techniques used by banks, banks shall apply one of the following approaches:

1) treat it as if there were no counterparty risk arising from the position in that credit derivative;

2) consistently include for the purpose of calculating the own funds requirements for counterparty credit risk all credit derivatives in the trading book forming part of internal hedges or purchased as protection against a CCR exposure where the credit protection is recognized as eligible in accordance with Regulation No 112/2018 on credit risk mitigation techniques used by banks.

Chapter VIII
OWN FUNDS REQUIREMENTS FOR EXPOSURES TO A CENTRAL COUNTERPARTY

77. CCP-related transaction means a contract or a transaction, as listed in Annex No 1 to Regulation No 114/2018 on the treatment of market risk under the standardized method and in point 4 of this Regulation, between a client and a clearing member that is directly related to a contract or a transaction between that clearing member and a CCP.

78. Where the bank has contracts listed in Annex No 1 to Regulation No 114/2018 on the treatment of market risk under the standardized approach, credit derivatives and long settlement transactions, as long as they are outstanding with the participation of a CCP, the bank shall apply the provisions of point 79.

79. Where the bank is a client, it shall calculate the own funds requirements for its CCP-related transactions with the clearing member in accordance with this Regulation or the Regulation on the treatment of credit assessment adjustment risk for banks.