DECISION no. 112 of 24 May 2018

on the approval of the Regulation on credit risk mitigation techniques of banks

(in force since 30.07.2018)

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Registered
by the Ministry of Justice
of the Republic of Moldova
under no. 1329 of 31 May 2018

Pursuant to Art. 5 par. (1) (d), Art. 11 par. (1), Art. 27 (1) (c), Art.44 (a), Art. 46 (b) of the Law no. 548-XIII of July 21, 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 and completions; Art. 67 of the Law no. 202 of 6 October 2017 on the Banking activity (Official Monitor of the Republic of Moldova, 2017, no. 434-439, Art.727), with subsequent amendments and completions, the Executive Board of the National Bank of Moldova

DECIDES:

1. To approve the Regulation on credit risk mitigation techniques of banks, as laid down in Annex hereto.
2. The Regulation referred to in paragraph 1 shall enter into force on 30 July 2018.
3. From the date of entry into force of the Regulation referred to in paragraph 1 of this decision, banks will ensure full compliance of their businesses, including internal policies and regulations, with its provisions.

**Chairman
of the Executive Board
of the National Bank of Moldova** **Sergiu CIOCLEA**

no. 112 of 24 May 2018

Annex

Approved
by the Decision of the Executive Board
of the National Bank of Moldova
no. 112 of 24 May 2018

Note: Throughout the text, the phrase "the Regulation of the National Bank of Moldova on the treatment of bank's credit risk using a standardised approach", at the appropriate grammatical form, shall be substituted for "Regulation No 111/2018", at the appropriate grammatical form according to the Decision of the NBM no.275 of 29.12.2022, in force 13.02.2023.

REGULATION
on credit risk mitigation techniques of banks

This Regulation transposes Art. 192-198, Art. 200, Art.201, Art. 203-207, Art. 212-216, Art. 218-220, Art. 222-224, Art. 226-228, Art. 232-233, Art.235, Art. 237-241 of Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No. 648/2012 (Text with EEA relevance), published in the Official Journal of the European Union L 176 of 27 June 2013, as amended by Commission Regulation (EU) 2015/62 of 10 October 2014.

TITLE I
GENERAL DISPOSITIONS

Chapter I
GENERAL PROVISIONS AND DEFINITIONS

Section 1
Subject matter and scope

1. This Regulation shall apply to banks headquartered in the Republic of Moldova as well as to branches of foreign banks, established in the Republic of Moldova and licensed by the National Bank of Moldova, hereinafter referred to as banks. This Regulation applies both on an individual and consolidated basis.

[Paragraph 1 amended by Decision of the NBM no.16 of 03.02.2022, in force 25.03.2022]

2. This Regulation sets out methods of determining the effect of credit risk mitigation techniques on the calculation of the risk-weighted exposure amount when using the Standardised approach to credit risk, namely:

1) principles for recognising the effect of credit risk mitigation techniques as well as principles governing the eligibility of credit risk mitigation techniques;

2) forms of credit protection that banks may use for credit risk mitigation;

3) minimum requirements that any eligible form of credit protection has to meet to ensure recognition of its effects on credit risk mitigation;

4) the calculation of the effects of eligible credit protection on credit risk mitigation.

Section 2
General provisions and definitions

3. The terms and expressions used in this Regulation shall have the meaning provided in the Law no. 202 of 6 October 2017 on the Banking Activity (Official Monitor of the Republic of Moldova, 2017, no. 434-439, Art.727) and in the regulatory acts of the National Bank of Moldova issued in its application. In addition, for the purposes of this Regulation, the following definitions shall apply:

repurchase agreement and reverse repurchase agreement shall mean any agreement in which a bank or its counterparty transfers securities or commodities or guaranteed rights relating to titles to securities or commodities where that guarantee is issued by a recognised exchange which holds the rights to the securities or commodities and the agreement does not allow a bank to transfer or pledge a particular security or commodity to more than one counterparty at one time, subject to a commitment to repurchase them, or to substituted securities or commodities of the same description at a specified price on a future date specified, or to be specified, by the transferor, being a repurchase agreement for the bank selling the securities or commodities and a reverse repurchase agreement for the bank buying them;

margin agreement shall mean an agreement or provisions of an agreement under which one counterparty must supply collateral to a second counterparty when an exposure of that second counterparty to the first counterparty exceeds a specified level (margin threshold);

credit risk mitigation shall mean a technique used by a bank to reduce the credit risk associated with an exposure or exposures which that bank continues to hold;

cash assimilated instrument shall mean a certificate of deposit, a bond, including a covered bond, or any other non-subordinated instrument, which has been issued by a bank, for which the bank has already received full payment and which shall be unconditionally reimbursed by the bank at its nominal value;

financial collateral shall mean the collateral in the form of cash and financial instruments;

underlying CIU shall mean a CIU in the shares or units of which another CIU has invested;

capital market-driven transaction shall mean any transaction giving rise to an exposure secured by collateral which includes a provision conferring upon the bank the right to receive margin at least daily;

margin threshold shall mean the largest amount of an exposure that remains outstanding before one party has the right to call for collateral;

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

unfunded credit protection shall mean a technique of credit risk mitigation where the reduction of the credit risk on the exposure of a bank derives from the obligation of a third party to pay an amount in the event of the default of the borrower or the occurrence of other specified credit events;

lending bank shall mean the bank which has the exposure in question;

secured lending transaction shall mean any transaction giving rise to an exposure secured by collateral which does not include a provision conferring upon the bank the right to receive margin at least daily;

margin lending transaction shall mean a transaction in which a bank 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;

repurchase transaction shall mean any transaction governed by a repurchase agreement or a reverse repurchase agreement;

fully adjusted value of the exposure *(E*)* shall mean the exposure value resulting from the application of the risk mitigation technique under the Financial Collateral Comprehensive Method.

4. In the case of an exposure for which a bank applies the Standardised approach under the Regulation on the treatment of banks' credit risk using standardized approach, approved by the Decision of the Executive Board of the National Bank of Moldova No 111/2018 (hereinafter – Regulation No 111/2018), the bank may use credit risk mitigation techniques laid down in this

Regulation to calculate the risk-weighted values of exposures for the purposes of the provisions of the NBM's Regulation on banks' own funds and capital requirements.
[Paragraph 4 amended by Decision of the NBM no.275 of 29.12.2022, in force 13.02.2023]

Chapter II
GENERAL REQUIREMENTS

Section 1
Principles for recognising the effect of credit risk mitigation techniques

5. No exposure in respect of which a bank obtains credit risk mitigation shall produce a higher risk-weighted exposure amount than an otherwise identical exposure in respect of which a bank has no credit risk mitigation.

6. Where the risk-weighted exposure amount already takes account of credit protection under the Regulation No 111/2018, banks shall not take into account that credit protection in the calculations under this Regulation.

7. Where the provisions of Titles II and III are met, banks may amend the calculation of risk-weighted exposure amounts under the standardised approach and the calculation of risk-weighted exposure amounts in accordance with the provisions of Titles IV, V and VI.

8. Banks shall treat cash, securities or commodities purchased, borrowed or received under a repurchase transaction or securities or commodities lending or borrowing transaction as collateral.

9. Where a bank uses more than one form of credit risk mitigation covering a single exposure it shall do both of the following:

1) subdivide the exposure into parts covered by each type of credit risk mitigation tool; and

2) calculate the risk-weighted exposure amount for each part obtained in paragraph (1) separately in accordance with the provisions of the Regulation No 111/2018 and of this Regulation.

10. When a bank covers a single exposure with credit protection provided by a single protection provider and that protection has differing maturities, it shall do both of the following:

1) subdivide the exposure into parts covered by each type of credit risk mitigation tool; and

2) calculate the risk-weighted exposure amount for each part obtained in paragraph (1) separately in accordance with the provisions of the Regulation No 111/2018 and of this Regulation.

Section 2
Principles governing the eligibility of credit risk mitigation techniques

11. The technique used to provide the credit protection together with the actions and steps taken and procedures and policies implemented by the lending bank shall be such as to result in credit protection arrangements, which are legally effective and enforceable in all relevant jurisdictions.

12. Upon the request of the National Bank of Moldova, the lending bank shall provide an independent, written and reasoned legal opinion that it used to establish whether its credit protection arrangement meets the conditions laid down in Article 11.

13. The lending bank shall take all appropriate steps to ensure the effectiveness of the credit protection arrangement and to address the risks related to that arrangement.

14. Banks may recognise funded credit protection in the calculation of the effect of credit risk mitigation only where the assets relied upon for protection meet both of the following conditions:

1) they are included in the list of eligible assets set out in Sections 3 to 5 of Chapter III, as applicable; and

2) they are sufficiently liquid and their value over time sufficiently stable to provide appropriate certainty as to the credit protection achieved having regard to the degree of recognition allowed.

15. Banks may recognise funded credit protection in the calculation of the effect of credit risk mitigation only where the lending bank has the right to liquidate or retain, in a timely manner, the assets from which the protection derives in the event of the default, insolvency or bankruptcy or other credit event set out in the transaction documentation of the obligor and, where applicable, of the custodian holding the collateral. The degree of correlation between the value of the assets relied upon for protection and the credit quality of the obligor shall not be too high.

16. In the case of unfunded credit protection, a protection provider shall qualify as an eligible protection provider only where the protection provider is included in the list of eligible protection providers set out in Article 36.

17. In the case of unfunded credit protection, a protection agreement shall qualify as an eligible protection agreement only where it meets both the following conditions:

1) it meets the eligible protection criteria set forth in Articles 37 and 38;

2) it is legally effective and enforceable in the relevant jurisdictions, to provide appropriatecertainty as to the credit protection achieved having regard to the degree of recognition allowed;

3) the protection provider is included in the list of eligible protection providers.

18. Credit protection shall comply with the requirements set out in Title III.

19. A bank shall have in place adequate risk management processes to control those risks to which it may be exposed as a result of carrying out credit risk mitigation practices.

20. Notwithstanding the fact that credit risk mitigation has been taken into account for the purpose of calculating risk-weighted exposure amounts, banks shall continue to undertake a full credit risk assessment of the underlying exposure and be in a position to demonstrate the fulfilment of this requirement to the National Bank of Moldova. In the case of repurchase transactions and securities lending or commodities lending or borrowing transactions the underlying exposure shall, for the purposes of this paragraph only, be deemed to be the net amount of the exposure.

TITLE II
ELIGIBLE FORMS OF CREDIT RISK MITIGATION

Chapter III
FUNDED CREDIT PROTECTION

Section 1
On-balance sheet netting

21. A bank may use on-balance sheet netting of mutual claims between itself and its counterparty as an eligible form of credit risk mitigation.

22. Without prejudice to Section 2 of this Chapter, eligibility is limited to reciprocal cash balances between the bank and the counterparty of the exposure secured by collateral. Banks may amend risk-weighted exposure amounts only for loans and deposits that they have received themselves and that are subject to an on-balance sheet netting agreement.

Section 2
Master netting agreements covering repurchase transactions or securities or commodities lending or borrowing transactions or other capital market-driven transactions

23. Banks adopting the Financial Collateral Comprehensive Method set out in Section 5 of Chapter VIII may take into account the effects of bilateral netting contracts covering repurchase transactions, securities or commodities lending or borrowing transactions, or other capital market-driven transactions with a counterparty.

24. The collateral taken and securities or commodities borrowed within such agreements or transactions specified under Article 23 shall comply with the eligibility requirements for collateral set out in Sections 3 and 4 of this Chapter.

Section 3
Eligibility of collateral under all approaches and methods

25. Banks may use the following items as eligible collateral under all approaches and methods:

1) Cash on deposits or extended as loans to banks, in the part which is used as irrevocable collateral for loans extended by the bank, or cash assimilated instruments held by the lending bank of international organisations, multilateral development banks, legal entities, including banks which, individually or in the group of which they are part, have a credit assessment by an external credit assessment institution (ECAI), which the National Bank of Moldova determined to be associated with the credit quality step 3 or above, in accordance with the rules for the risk weighting of exposures to banks, as set out in the Regulation No 111/2018;

2) Government securities and Certificates of the National Bank of Moldova (NBC);

3) debt securities other than those specified in paragraph (2), issued by central governments or central banks, having a credit assessment by an ECAI or an export credit agency recognised as eligible within the meaning of the National Bank of Moldova for the purposes of the Regulation No 111/2018, which the National Bank of Moldova determined to be associated with the credit quality step 4 or above according to the rules for the risk weighting of exposures to central governments and central banks, as set out in the above-mentioned Regulation;

4) debt securities issued by banks which securities have a credit assessment by an ECAI which has been determined by the National Bank of Moldova to be associated with credit quality step 3 or above under the rules for the risk weighting of exposures to banks in accordance with the Regulation No 111/2018;

5) debt securities issued by other entities which securities have a credit assessment by an ECAI which has been determined by the National Bank of Moldova to be associated with credit quality step 3 or above under the rules for the risk weighting of exposures to corporates under the Regulation No 111/2018;

6) debt securities with a short-term credit assessment by an ECAI which has been determined by the National Bank of Moldova to be associated with credit quality step 3 or above under the rules for the risk weighting of short-term exposures under the Regulation No 111/2018;

7) equities or convertible bonds that are included in a main index;

8) gold

26. For the purposes of paragraph (3) of Article 25, debt securities issued by central governments or central banks shall include all the following:

1) debt securities issued by public sector entities, which are treated as exposures to central governments in accordance with the Regulation No 111/2018;

2) debt securities issued by multilateral development banks to which a 0% risk weight is assigned under the Regulation No 111/2018;

3) debt securities issued by international organisations, which are assigned a 0% risk weight under the Regulation No 111/2018.

27. For the purposes of paragraph (4) of Article 25, debt securities issued by banks shall include all the following

1) debt securities issued by regional governments or local authorities other than debt securities referred to in paragraph (1) of Article 26;

2) debt securities issued by public sector entities, exposures to which are treated in accordance with the Regulation No 111/2018;

3) debt securities issued by multilateral development banks other than those to which a 0% risk weight is assigned under the Regulation No 111/2018;

4) debt securities issued by foreign banks / investment firms, exposures to which are treated as exposures to banks in accordance with the Regulation No 111/2018;

28. A bank may use debt securities that are issued by other banks and that do not have a credit assessment by an ECAI as eligible collateral where those debt securities meet all the following criteria:

1) they are listed on a recognised exchange;

2) they qualify as senior debt;

3) all other rated issues by the issuing bank of the same seniority have a credit assessment by an ECAI which has been determined by the NBM to be associated with credit quality step 3 or above under the rules for the risk weighting of exposures to banks or short-term exposures specified under the Regulation No 111/2018;

4) the lending bank has no information to suggest that the issue would justify a credit assessment below that indicated in paragraph (3);

5) the market liquidity of the instrument is sufficient for these purposes.

29. With regard to paragraphs (3) to (6) of Article 25, where a security has two credit assessments by ECAIs, banks shall apply the less favourable assessment. Where a security has more than two credit assessments by ECAIs, banks shall apply the two most favourable assessments. Where the two most favourable credit assessments are different, banks shall apply the less favourable of the two.

Section 4
Additional eligibility of collateral under the Financial Collateral Comprehensive Method

30. In addition to the collateral established in Section 3 of this Chapter, where a bank uses the Financial Collateral Comprehensive Method set out in Section 5 of Chapter VIII, that bank may use the following items as eligible collateral:

1) equities or convertible bonds not included in a main index but traded on a recognised exchange;

2) units or shares in CIUs where both the following conditions are met:

a) the units or shares have a daily public price quote;

b) the CIU is limited to investing in instruments that are eligible for recognition under Articles 25 and 28 and the items mentioned in paragraph (1) of this Article.

31. In the case a CIU invests in units or shares of another CIU, conditions of paragraph (1) and (2) of Article 30 equally apply to any such underlying CIU.

32. The use by a CIU of derivative instruments to hedge permitted investments shall not prevent units or shares in that undertaking from being eligible as collateral.

33. Where the CIU or any underlying CIU are not limited to investing in instruments that are eligible for recognition under Articles 25 and 28 and the items mentioned in paragraph (1) of Article 30, banks may use units or shares in that CIU as collateral to an amount equal to the value of the eligible assets held by that CIU under the assumption that that CIU or any of its underlying CIUs have invested in non-eligible assets to the maximum extent allowed under their respective mandates.

34. Where non-eligible assets can have a negative value due to liabilities or contingent liabilities resulting from ownership, banks shall do both of the following:

1) calculate the total value of the non-eligible assets; and

2) where the amount obtained under paragraph (1) is negative, subtract the absolute value of that amount from the total value of the eligible assets.

Section 5
Other funded credit protection

35. Banks may use the following other funded credit protection as eligible collateral:

1) cash on deposit with a third party bank which, individually or in the group of which they are part, have a credit assessment by an ECAI, which the National Bank of Moldova has determined to be associated with the credit quality step 3 or above, in accordance with the rules for the risk weighting of exposures to banks or short-term exposures, as set out in the Regulation No 111/2018, or cash assimilated instruments held by a third party bank, provided that they are held in a non-custodial arrangement and pledged to the lending bank;

2) instruments issued by third party banks / investment firms having a credit assessment by an ECAI, which the National Bank of Moldova has determined to be associated with the credit quality step 3 or above in accordance with the rules for the risk weighting of exposures to banks or short-term exposures, as set out in the Regulation No 111/2018, which will be repurchased by that bank / investment firm on request.

Chapter IV
UNFUNDED CREDIT PROTECTION

36. Banks may use the following parties as eligible providers of unfunded credit protection:

1) central governments and central banks, regional governments or local authorities, multilateral development banks, international organisations, exposures to which are assigned a risk weight of 0% according to the Regulation No 111/2018;

2) public sector entities treated in accordance with the Regulation No 111/2018;

3) bank which, individually or in the group of which they are part, have a credit assessment by an ECAI, which the National Bank of Moldova has determined to be associated with the credit quality step 3 or above, in accordance with the rules for the risk weighting of exposures to banks or short-term exposures, as set out in the Regulation No 111/2018, or cash assimilated instruments held by a third party bank;

4) other corporate entities, including parent undertaking, subsidiaries and affiliate corporate entities of the bank, where those other corporate entities have an individual credit assessment by an ECAI, which the National Bank of Moldova has associated with the credit quality step 3 or above in accordance with the rules for risk weighting of exposures to banks or short-term exposures as set out in the Regulation No 111/2018;

5) central counterparties.

37. Banks may use guarantees as eligible unfunded credit protection in conditions laid down in Article 36.

Chapter V
ELIGIBLE TYPES OF CREDIT DERIVATIVES

38. Banks may use the following types of credit derivatives, and instruments that may be composed of such credit derivatives or that are economically effectively similar, as eligible credit protection:

1) credit default swaps;

2) total return swaps;

3) credit-linked notes to the extent of their cash funding.

39. Where a bank buys credit protection through a total return swap and records the net payments received on the swap as net income, but does not record the offsetting deterioration in the value of the asset that is protected either through reductions in fair value or by an addition to reserves, that credit protection does not qualify as eligible credit protection.

40. Where a bank conducts an internal hedge using a credit derivative, in order for the credit protection to qualify as eligible credit protection for the purposes of this Regulation, the credit risk transferred to the trading book shall be transferred out to a third party or parties.

41. Where an internal hedge has been conducted in accordance with Article 40 and the requirements in this Regulation have been met, banks shall apply the rules set out in Titles 4 to 6 for the calculation of risk-weighted exposure amounts where they acquire unfunded credit protection.

TITLE III
REQUIREMENTS

Chapter VI
REQUIREMENTS FOR FUNDED CREDIT PROTECTION

Section 1
Requirements for netting agreements

42. On-balance sheet netting agreements other than master netting agreements referred to in Article 43 shall qualify as an eligible form of credit risk mitigation where all the following conditions are met:

1) those agreements are legally effective and enforceable in all relevant jurisdictions, including in the event of the insolvency or bankruptcy of a counterparty;

2) banks are able to determine at any time the assets and liabilities that are subject to those agreements;

3) banks monitor and control the risks associated with the termination of the credit protection on an ongoing basis;

4) banks monitor and control the relevant exposures on a net basis and do so on an ongoing basis.

43. Master netting agreements covering repurchase transactions, securities or commodities lending or borrowing transactions or other capital market driven transactions shall qualify as an eligible form of credit risk mitigation where the collateral provided under those agreements meets all the requirements laid down in Articles 45 to 49 and where all the following conditions are met:

1) those agreements are legally effective and enforceable in all relevant jurisdictions, including in the event of the insolvency or bankruptcy of a counterparty;

2) they give the non-defaulting party the right to terminate and close-out in a timely manner all transactions under the agreement upon the event of default, including in the event of the bankruptcy or insolvency of the counterparty;

3) they provide for the netting of gains and losses on transactions closed out under an agreement so that a single net amount is owed by one party to the other.

Section 2
Requirements for financial collateral

44. Under all approaches and methods, financial collateral and gold shall qualify as eligible collateral where all the requirements laid down in Articles 45 to 49 are met.

45. The credit quality of the obligor and the value of the collateral shall not have a material positive correlation. Where the value of the collateral is reduced significantly, this shall not alone imply a significant deterioration of the credit quality of the obligor. Where the credit quality of the obligor becomes critical, this shall not alone imply a significant reduction in the value of the collateral.

46. Securities issued by the obligor, or any related group entity, shall not qualify as eligible collateral.

47. Banks shall fulfil any contractual and statutory requirements in respect of, and take all steps necessary to ensure, the enforceability of the collateral arrangements under the law applicable to their interest in the collateral.

48. Banks shall have conducted sufficient legal review confirming the enforceability of the collateral arrangements in all relevant jurisdictions. They shall re-conduct such review as necessary to ensure continuing enforceability.

49. Banks shall fulfil all the following operational requirements:

1) they shall properly document the collateral arrangements and have in place clear and comprehensive procedures for the timely liquidation of collateral;

2) they shall use robust procedures and processes to control risks arising from the use of collateral, including risks of failed or reduced credit protection, valuation risks, risks associated with the termination of the credit protection, concentration risk arising from the use of collateral and the interaction with the bank's overall risk profile;

3) they shall have in place documented policies and practices concerning the types and amounts of collateral accepted;

4) they shall calculate the market value of the collateral, and revalue it accordingly, at least once every six months and whenever they have reason to believe that a significant decrease in the market value of the collateral has occurred;

5) where the collateral is held by a third party, they shall take reasonable steps to ensure that the third party segregates the collateral from its own assets;

6) they shall ensure that they devote sufficient resources to the orderly operation of margin agreements with OTC derivatives and securities-financing counterparties, as measured by the timeliness and accuracy of their outgoing margin calls and response time to incoming margin calls;

7) they shall have in place collateral management policies to control, monitor and report the following:

a) the risks to which margin agreements expose them;

b) the concentration risk to particular types of collateral assets;

c) the reuse of collateral including the potential liquidity shortfalls resulting from the reuse of collateral received from counterparties;

d) the surrender of rights on collateral posted to counterparties.

50. In addition to meeting all the requirements set out in Articles 45 to 49, for financial collateral to qualify as eligible collateral under the Financial Collateral Simple Method the residual maturity of the protection shall be at least as long as the residual maturity of the exposure.

Section 3
Requirements for other forms of funded credit protection

51. Cash on deposit with, or cash assimilated instruments held by, a third party bank as laid down in paragraph (1) of Article 35 shall be eligible for the treatment referred to under Article 108, where all the following conditions are met:

1) the borrower's claim against the third party bank is openly pledged or assigned to the lending bank and such pledge or assignment is legally effective and enforceable in all relevant jurisdictions and is unconditional and irrevocable;

2) the third party bank is notified of the pledge or assignment;

3) as a result of the notification, the third party bank is able to make payments solely to the lending bank or to other parties only with the lending bank's prior consent.

Chapter VII
UNFUNDED CREDIT PROTECTION AND CREDIT-LINKED NOTE

Section 1
Requirements common to guarantees and credit derivatives

52. Section 1 lays down requirements that are common to guarantees and credit derivatives and that should be met at the same time as the specific requirements set out for guarantees in Section 3 and for credit derivatives in Section 4 of this Chapter.

53. Subject to Article 57, credit protection deriving from a guarantee or credit derivative shall qualify as eligible unfunded credit protection where all the following conditions are met:

1) the credit protection is direct;

2) the extent of the credit protection is clearly defined and incontrovertible;

3) the credit protection contract does not contain any clause, the fulfilment of which is outside the direct control of the lender, that:

a) would allow the protection provider to cancel the protection unilaterally;

b) would increase the effective cost of protection as a result of a deterioration in the credit quality of the protected exposure;

c) could prevent the protection provider from being obliged to pay out in a timely manner in the event that the original obligor fails to make any payments due, or when the leasing contract has expired for the purpose of recognising guaranteed residual value under the Regulation No 111/2018;

d) could allow the maturity of the credit protection to be reduced by the protection provider;

4) the credit protection contract is legally effective and enforceable in all jurisdictions which are relevant at the time of the conclusion of the credit agreement.

54. A bank shall have in place systems to manage potential concentration of risk arising from its use of guarantees and credit derivatives. A bank shall be able to demonstrate to the satisfaction of the National Bank of Moldova how its strategy in respect of its use of credit derivatives and guarantees interacts with its management of its overall risk profile.

55. A bank shall fulfil any contractual and statutory requirements in respect of, and take all steps necessary to ensure, the enforceability of its unfunded credit protection under the law applicable to its interest in the credit protection.

56. A bank shall have conducted sufficient legal review confirming the enforceability of the unfunded credit protection in all relevant jurisdictions. It shall repeat such review as necessary to ensure continuing enforceability.

Section 2
Sovereign and other public sector counter-guarantees

57. Banks may treat the exposures referred to Article 58 as protected by a guarantee provided by the entities listed therein, provided all the following conditions are satisfied:

1) the counter-guarantee covers all credit risk elements of the claim;

2) both the original guarantee and the counter-guarantee meet the requirements for guarantees set out in Section 1 of this Chapter and in Article 60, except that the counter-guarantee need not be direct;

3) the cover is robust and nothing in the historical evidence suggests that the coverage of the counter-guarantee is less than effectively equivalent to that of a direct guarantee by the entity in question.

58. The treatment set out in Article 57 shall apply to exposures protected by a guarantee which is counter-guaranteed by any of the following entities:

1) a central government or central bank;

2) a regional government or local authority;

3) a public sector entity, claims on which are treated as claims on the central government in accordance with the Regulation No 111/2018;

4) a multilateral development bank or international organisation, exposures to which are assigned a risk weight of 0% according to the Regulation No 111/2018;

5) a public sector entity, claims on which are treated in accordance with the Regulation No 111/2018;

59. Banks shall apply the treatment set out in Article 57 also to an exposure, which is not counter-guaranteed by any entity listed in Article 58, where that exposure's counter-guarantee is in turn directly guaranteed by one of those entities and the conditions listed in Article 57 are met.

Section 3
Additional requirements for guarantees

60. Guarantees shall qualify as eligible unfunded credit protection where all the conditions in Section 1 of this Chapter and all the following conditions are met:

1) on the qualifying default of or non-payment by the counterparty, the lending bank has the right to pursue, in a timely manner, the guarantor for any monies due under the claim in respect of which the protection is provided and the payment by the guarantor shall not be subject to the lending bank first having to pursue the obligor. In the case of unfunded credit protection covering residential mortgage loans, the requirements of paragraph (3) letter (c) of Article 53 and the first sentence of this paragraph must be met within 24 months;

2) the guarantee is an explicitly documented obligation assumed by the guarantor;

3) either of the following conditions is met:

a) the guarantee covers all types of payments the obligor is expected to make in respect of the claim;

b) where certain types of payment are excluded from the guarantee, the lending bank has adjusted the value of the guarantee to reflect the limited coverage.

61. In the case of guarantees provided in the context of mutual guarantee schemes or provided by or counter-guaranteed by entities listed in Article 58, the requirements of paragraph (1) of Article 60 shall be considered to be satisfied where either of the following conditions is met:

1) the lending bank has the right to obtain in a timely manner a provisional payment by the guarantor that meets both the following conditions:

a) it represents a robust estimate of the amount of the loss, including losses resulting from the non-payment of interest and other types of payment which the borrower is obliged to make, that the lending bank is likely to incur;

b) it is proportional to the coverage of the guarantee.

2) the lending bank can demonstrate to the satisfaction of the National Bank of Moldova that the effects of the guarantee, which shall also cover losses resulting from the non-payment of interest and other types of payments which the borrower is obliged to make, justify such treatment.

Section 4
Additional requirements for credit derivatives

62. Credit derivative shall qualify as eligible unfunded credit protection where all the conditions laid down in Section 1 of this Chapter and all the following conditions are met:

1) the credit events specified in the credit derivative contract include:

a) the failure to pay the amounts due under the terms of the underlying obligation that are in effect at the time of such failure, with a grace period that is equal to or shorter than the grace period in the underlying obligation;

b) the bankruptcy, insolvency or inability of the obligor to pay its debts, or its failure or admission in writing of its inability generally to pay its debts as they become due, and analogous events;

c) the restructuring of the underlying obligation involving forgiveness or postponement of principal, interest or fees that results in a credit loss event;

2) where credit derivatives allow for cash settlement:

a) banks have in place a robust valuation process in order to estimate loss reliably;

b) there is a clearly specified period for obtaining post-credit-event valuations of the underlying obligation;

3) where the protection purchaser's right and ability to transfer the underlying obligation to the protection provider is required for settlement, the terms of the underlying obligation provide that any required consent to such transfer shall not be unreasonably withheld;

4) the identity of the parties responsible for determining whether a credit event has occurred is clearly defined;

5) the determination of the credit event is not the sole responsibility of the protection provider;

6) the protection buyer has the right or ability to inform the protection provider of the occurrence of a credit event.

63. Where the credit events do not include restructuring of the underlying obligation as described in paragraph (1) letter (c) of Article 62, the credit protection may nonetheless be eligible subject to a reduction in the value as specified in Article 111.

64. A mismatch between the underlying obligation and the reference obligation under the credit derivative or between the underlying obligation and the obligation used for purposes of determining whether a credit event has occurred is permissible only where both the following conditions are met:

1) the reference obligation or the obligation used for the purpose of determining whether a credit event has occurred, as the case may be, ranks pari passu with or is junior to the underlying obligation;

2) the underlying obligation and the reference obligation or the obligation used for the purpose of determining whether a credit event has occurred, as the case may be, share the same obligor and legally enforceable cross-default or cross-acceleration clauses are in place.

TITLE IV
CALCULATING THE EFFECTS OF CREDIT RISK MITIGATION

Chapter VIII
CALCULATING THE EFFECTS OF FUNDED CREDIT PROTECTION

Section 1
On-balance sheet netting and credit-linked notes

65. Loans to and deposits with the lending bank subject to on-balance sheet netting are to be treated by that bank as cash collateral for the purpose of calculating the effect of funded credit protection for those loans and deposits of the lending bank subject to on-balance sheet netting which are denominated in the same currency.

66. Investments in credit-linked notes issued by the lending bank may be treated as cash collateral for the purpose of calculating the effect of funded credit protection in accordance with this Chapter, provided that the credit default swap embedded in the credit-linked note qualifies as eligible unfunded credit protection.

67. For the purpose of determining whether the credit default swap embedded in a credit-linked note qualifies as eligible unfunded credit protection, the bank may consider the condition set out in paragraph (3) of Article 17 to be met.

Section 2

Using the Supervisory Volatility Adjustments Approach for master netting agreements

68. When banks calculate the fully adjusted value of exposure (E*) for the exposures subject to an eligible master netting agreement covering repurchase transactions or securities or commodities lending or borrowing transactions or other capital market-driven transactions, they shall calculate the volatility adjustments that they need to apply by using the Supervisory Volatility Adjustments Approach as set out in Sections 5 to 7 of this Chapter for the Financial Collateral Comprehensive Method.

69. For the purpose of calculating E*, banks shall:

1) calculate the net position in each group of securities or in each type of commodity by subtracting the amount in point (b) from the amount in point (a) in this Article:

a) the total value of a group of securities or of commodities of the same type lent, sold or provided under the master netting agreement;

b) the total value of a group of securities or of commodities of the same type borrowed, purchased or received under the master netting agreement;

2) calculate the net position in each currency, other than the settlement currency of the master netting agreement, by subtracting the amount in point (b) from the amount in point (a) in this Article:

a) the sum of the total value of securities denominated in that currency lent, sold or provided under the master netting agreement and the amount of cash in that currency lent or transferred under that agreement;

b) the sum of the total value of securities denominated in that currency borrowed, purchased or received under the master netting agreement and the amount of cash in that currency borrowed or received under that agreement;

3) apply the volatility adjustment appropriate to a given group of securities or to a cash position to the absolute value of the positive or negative net position in the securities in that group;

4) apply the foreign exchange risk (fx) volatility adjustment to the net positive or negative position in each currency other than the settlement currency of the master netting agreement.

70. Banks shall calculate E* according to the following formula:

$$E^* = \max\left\{0, \left(\sum_i E_i - \sum_i C_i\right) + \sum_j \left|E_j^{sec}\right| \cdot H_j^{sec} + \sum_k \left|E_k^{fx}\right| \cdot H_k^{fx}\right\}$$

where:

E_i = the exposure value for each separate exposure *i* under the agreement that would apply in the absence of the credit protection;

C_i = the value of securities in each group or commodities of the same type borrowed, purchased or received or the cash borrowed or received in respect of each exposure *i*;

E_j^{sec} = the net position (positive or negative) in a given group of securities *j*;

E_k^{fx} = the net position (positive or negative) in a given currency *k* other than the settlement currency of the agreement as calculated under paragraph (2) of Article 69;

H_j^{sec} = the volatility adjustment appropriate to a particular group of securities *j*;

H_k^{fx} = the foreign exchange volatility adjustment for currency *k,* as calculated under Section 6 of this Chapter.

71. For the purpose of calculating risk-weighted exposure amounts for repurchase transactions or securities or commodities lending or borrowing transactions or other capital market-driven transactions covered by master netting agreements, banks shall use the fully adjusted value of exposure (E*), as calculated under Article 70, as the exposure value of the exposure to the counterparty arising from the transactions subject to the master netting agreement for the purposes of the Regulation No 111/2018.

72. For the purposes of Articles 69 and 70, “group of securities” shall mean securities, which are issued by the same entity, have the same issue date, the same maturity, are subject to the same terms and conditions, and are subject to the same liquidation periods, as applicable, as indicated in Section 6 of this Chapter.

Section 3
General provisions on the methods applicable to financial collaterals

73. To calculate the risk-weighted exposure amounts of the exposures secured by financial collateral, the Financial Collateral Simple Method or the Financial Collateral Comprehensive Method may be used as laid down in Sections 4 and 5, respectively, of this Chapter.

74. Banks shall use either of the two methods specified above.

Section 4
Financial Collateral Simple Method

75. Under the Financial Collateral Simple Method, banks shall assign to eligible financial collateral a value equal to its market value as determined in accordance with paragraph (4) of Article 49.

76. Banks shall assign to those portions of exposure values that are collateralised by the market value of eligible collateral the risk weight that they would assign under the Regulation No 111/2018 where the lending bank had a direct exposure to the collateral instrument. For this purpose, the exposure value of an off-balance sheet item shall be equal to 100% of the item's value rather than the exposure value determined under the above-mentioned Regulations.

77. The risk weight of the collateralised portion shall be at least 20%, except as specified in Articles 79 to 82.

78. Banks shall apply to the remainder of the exposure value the risk weight that they would assign to an unsecured exposure to the counterparty under the provisions of the Regulation No 111/2018.

79. Banks shall assign a risk weight of 0% to the collateralised portion of the exposure arising from the repurchase transaction and securities lending or borrowing transactions, which fulfil the criteria set forth in Section 8 of this Chapter. Where the counterparty to the transaction is not a core market participant, banks shall assign a risk weight of 10%.

80. Banks shall assign a risk weight of 0%, to the extent of the collateralisation, to the exposure values for the derivative instruments subject to daily marking-to-market, collateralised by cash or cash-assimilated instruments where there is no currency mismatch.

81. Banks shall assign a risk weight of 10%, to the extent of the collateralisation, to the exposure values of transactions similar to those referred to in Article 80, collateralised by debt securities issued by central governments or central banks, which are assigned a 0% risk weight under the Regulation No 111/2018.

82. For transactions other than those referred to in Articles 79-81, banks may assign a 0% risk weight where the exposure and the collateral are denominated in the same currency, and either of the following conditions is met:

1) the collateral is cash on deposit or a cash assimilated instrument under paragraph (1) of Article 25;

2) the collateral is in the form of debt securities issued by central governments or central banks eligible for a 0% risk weight under the Regulation No 111/2018, and its market value has been discounted by 20%.

83. For the purposes of Articles 81 and 82, debt securities issued by central governments or central banks shall also include:

1) debt securities issued by multilateral development banks which are assigned a 0% risk weight;

2) debt securities issued by international organisations which are assigned a 0% risk weight;

3) debt securities issued by public sector entities which are treated as exposures to central governments in accordance with the Regulation No 111/2018.

Section 5
Financial Collateral Comprehensive Method

84. In order to take account of price volatility, banks shall apply volatility adjustments to the market value of collateral, as set out in Sections 6 to 8 of this Chapter, when valuing financial collateral for the purposes of the Financial Collateral Comprehensive Method.

85. Where collateral is denominated in a currency that differs from the currency in which the underlying exposure is denominated, banks shall add an adjustment reflecting currency volatility, as set out in Sections 6 to 8 of this Chapter, to the volatility adjustment appropriate to the collateral, according to Article 84.

86. In the case of OTC derivatives transactions covered by netting agreements, banks shall apply a volatility adjustment reflecting currency volatility when there is a mismatch between the collateral currency and the settlement currency. Even where multiple currencies are involved in the transactions covered by the netting agreement, banks shall apply a single volatility adjustment.

87. Banks shall calculate the volatility-adjusted value of the collateral (C_{VA}) they need to take into account as follows:

$$\mathbf{C_{VA} = C \bullet (1 - H_C - H_{fx})}$$

where:

C = the value of the collateral;

H_C = the volatility adjustment appropriate to the collateral, as calculated under Sections 6 and 8 of this Chapter;

H_{fx} = the volatility adjustment appropriate to currency mismatch, as calculated under Sections 6 and 8 of this Chapter.

88. Banks shall use the formula in Article 87 when calculating the volatility-adjusted value of the collateral for all transactions except for those transactions subject to recognised master netting agreements to which the provisions set out in Section 2 of this Chapter apply.

89. Banks shall calculate the volatility-adjusted value of the exposure ($\mathbf{E_{VA}}$) they need to take into account as follows:

$$\mathbf{E_{VA} = E \bullet (1 + H_E)}$$

where:

E = the exposure value as would be determined under the Regulation No 111/2018 where the exposure was not collateralised;

H_E = the volatility adjustment appropriate to the exposure, as calculated under Sections 6 and 8 of this Chapter.

90. Notwithstanding Article 89, in the case of OTC derivative transactions, banks shall calculate $\mathbf{E_{VA}}$ as follows:

$$\mathbf{E_{VA} = E}$$

91. For the purpose of calculating E in Article 90, for banks calculating risk-weighted exposure amounts under the standardised approach, the exposure value of an off-balance sheet item listed in the Regulation No 111/2018 shall be 100% of that item's value rather than the exposure value indicated in that Regulation;

92. Banks shall calculate the fully adjusted value of the exposure (E*), taking into account both volatility and the risk-mitigating effects of collateral as follows:

$$E^* = \max\{0, E_{VA} - C_{VAM}\}$$

where:

E_{VA} = the volatility adjusted value of the exposure as calculated in Articles 89 and 90;

C_{VAM} = C_{VA} further adjusted for any maturity mismatch in accordance with the provisions of Title V.

93. Banks shall calculate volatility adjustments by using the Supervisory Volatility Adjustments Approach referred to in Section 6 of this Chapter.

94. Where the collateral consists of a number of eligible items, banks shall calculate the volatility adjustment (**H**) as follows:

$$H = \sum_i a_i H_i$$

where:

a_i = the proportion of the value of an eligible item *i* in the total value of collateral;

H_i = the volatility adjustment applicable to eligible item *i*.

Section 6
Supervisory volatility adjustments under the Financial Collateral Comprehensive Method

95. The volatility adjustments to be applied by banks under the Supervisory Volatility Adjustments Approach, assuming daily revaluation, shall be those set out in Tables 1 to 4 of this Section.

VOLATILITY ADJUSTMENTS

Table 1

Credit quality step with which the credit assessment of the debt security is associated	Residual maturity	Volatility adjustments for debt securities issued by entities described in par. (2) and (3) of Article 25			Volatility adjustments for debt securities issued by entities described in par. (4) and (4) of Article 25		
		20-day liquidation period (%)	**10-day liquidation period (%)**	**5-day liquidation period (%)**	**20-day liquidation period (%)**	**10-day liquidation period (%)**	**5-day liquidation period (%)**
1	≤ 1 year	0,707	0,5	0,354	1,414	1	0,707
	> 1 ≤ 5 years	2,828	2	1,414	5,657	4	2,828
	> 5 year	5,657	4	2,828	11,314	8	5,657
2-3	≤ 1 year	1,414	1	0,707	2,828	2	1,414
	> 1 ≤ 5 years	4,243	3	2,121	8,485	6	4,243
	> 5 years	8,485	6	4,243	16,971	12	8,485
4	≤ 1 year	21,213	15	10,607	N/A	N/A	N/A
	> 1 ≤ 5 years	21,213	15	10,607	N/A	N/A	N/A
	> 5 years	21,213	15	10,607	N/A	N/A	N/A

Table 2

Credit quality step with which the credit assessment of a short-term debt security is associated	Volatility adjustments for debt securities issued by entities described in par. (2) and (3) of Article 25 with short-term credit assessments			Volatility adjustments for debt securities issued by entities described in par. (4) and (5) of Article 25 with short-term credit assessments		
	20-day liquidation period (%)	10-day liquidation period (%)	5-day liquidation period (%)	20-day liquidation period (%)	10-day liquidation period (%)	5-day liquidation period (%)
1	0,707	0,5	0,354	1,414	1	0,707
2-3	1,414	1	0,707	2,828	2	1,414

Table 3

Other collateral or exposure types

Type of collateral	20-day liquidation period (%)	10-day liquidation period (%)	5-day liquidation period (%)
Main index equities, Main index convertible bonds	21,213	15	10,607
Other equities or convertible bonds listed on a recognised exchange	35,355	25	17,678
Cash	0	0	0
Gold	21,213	15	10,607

Table 4

Volatility adjustment for currency mismatch

20-day liquidation period (%)	10-day liquidation period (%)	5-day liquidation period (%)
11,314	8	5,657

96. The calculation of volatility adjustments in accordance with Article 95 shall be subject to the following conditions:

1) for secured lending transactions, the liquidation period shall be 20 business days;

2) for repurchase transactions (except insofar as such transactions involve the transfer of commodities or guaranteed rights relating to title to commodities) and securities lending or borrowing transactions, the liquidation period shall be 5 business days;

3) for other capital market driven transactions, the liquidation period shall be 10 business days.

97. The credit quality step, with which a credit assessment of the debt security referred to in the Tables contained in Article 95 and in Articles 99-101 is associated, is the credit quality step with which the credit assessment is determined by the National Bank of Moldova to be associated under the Regulation No 111/2018.

98. For the purposes of determining the credit quality step with which a credit assessment of the debt security referred to in Article 97 is associated, Article 29 also applies.

99. For non-eligible securities or for commodities lent or sold under repurchase transactions or securities or commodities lending or borrowing transactions, the volatility adjustment is the same as for non-main index equities listed on a recognised exchange.

100. For eligible units in CIUs, the volatility adjustment is the weighted average volatility adjustments that would apply, having regard to the liquidation period of the transaction as specified in Article 96, to the assets in which the fund has invested. Where the assets, in which the fund has invested, are not known to the bank, the volatility adjustment is the highest volatility adjustment that would apply to any of the assets in which the fund has the right to invest.

101. For unrated debt securities issued by banks and satisfying the eligibility criteria in Article 28, the volatility adjustments is the same as for securities issued by banks or corporates with an external credit assessment associated with credit quality steps 2 or 3.

Section 7
Scaling up of volatility adjustments under the Financial Collateral Comprehensive Method

102. The volatility adjustments set out in Section 6 of this Chapter are the volatility adjustments a bank shall apply where there is daily revaluation.

103. Where the frequency of revaluation is less than daily, banks shall apply larger volatility adjustments. Banks shall calculate them by scaling up the daily revaluation volatility adjustments, using the following square-root-of-time formula:

$$H = H_M \cdot \sqrt{\frac{N_R + (T_M - 1)}{T_M}}$$

where:

H = the volatility adjustment (scaling up) to be applied;

H_M = the volatility adjustment where there is daily revaluation;

N_R = the actual number of business days between revaluations;

T_M = the liquidation period for the type of transaction in question.

Section 8
Conditions for applying a 0% volatility adjustment under the Financial Collateral Comprehensive Method

104. In relation to repurchase transactions and securities lending or borrowing transactions, banks may, instead of applying the volatility adjustments calculated under Sections 6 and 7 of this Chapter, apply a 0% volatility adjustment where all of the following conditions are fulfilled:

1) both the exposure and the collateral are cash or debt securities issued by central governments or central banks within the meaning of paragraph (1) and (2) of Article 25 and eligible for a 0% risk weight under the Regulation No 111/2018;

2) both the exposure and the collateral are denominated in the same currency;

3) either the maturity of the transaction is no more than one day or both the exposure and the collateral are subject to daily marking-to-market or daily re-margining;

4) the time between the last marking-to-market before a failure to re-margin by the counterparty and the liquidation of the collateral is no more than four business days;

5) the transaction is settled in a settlement system proven for that type of transaction;

6) the documentation covering the agreement or transaction is standard market documentation for repurchase transactions or securities lending or borrowing transactions in the securities concerned;

7) the transaction is governed by documentation specifying that where the counterparty fails to satisfy an obligation to deliver cash or securities or to deliver margin or otherwise defaults, then the transaction is immediately terminable;

8) the counterparty is considered a core market participant.

105. The core market participants referred to in paragraph (8) of Article 104 shall include the following entities:

1) the entities mentioned in paragraph (1) and (2) of Article 25, exposures to which are assigned a 0% risk weight under the Regulation No 111/2018;

2) banks of the Republic of Moldova;

3) regulated CIUs of the Republic of Moldova that are subject to capital or leverage requirements;

4) regulated pension funds of the Republic of Moldova;

5) clearing organisations recognized in the Republic of Moldova.

Section 9
Calculation of risk-weighted exposure amounts under the Financial Collateral Comprehensive Method

106. Banks shall use the fully adjusted value of exposure (E*), as calculated under Article 92, as the exposure value for the purposes of the Regulation No 111/2018.

107. In the case of off-balance sheet items, banks shall use the fully adjusted value of exposure (E*) as the value to which the risk weights indicated in the Regulation No 111/2018 shall be applied to arrive at the exposure value.

Section 10
Other forms of funded credit protection

108. Where the conditions set out in Article 51 are met, deposits with third-party banks referred to in paragraph (1) of Article 35 may be treated as a guarantee provided by a third-party bank.

109. Banks may treat instruments repurchased on request that are eligible under paragraph (2) of Article 35 as a guarantee by the issuing bank / investment firm. The value of the eligible credit protection shall be the following:

1) where the instrument will be repurchased at its face value, the value of the protection shall be that amount;

2) where the instrument will be repurchased at market price, the value of the protection shall be the value of the instrument valued in the same way as the debt securities that meet the conditions listed in Article 28.

Chapter IX
CALCULATING THE EFFECTS OF UNFUNDED CREDIT PROTECTION

Section 1
Valuation

110. For the purpose of calculating the effects of unfunded credit protection in accordance with this Chapter, the value of unfunded credit protection (G) shall be the amount that the protection provider has undertaken to pay in the event of the default or non-payment of the borrower or on the occurrence of other specified credit events.

111. In the case of credit derivatives, which do not include as a credit event restructuring of the underlying obligation involving forgiveness or postponement of principal, interest or fees that result in a credit loss event, the following shall apply:

1) where the amount that the protection provider has undertaken to pay is not higher than the exposure value, banks shall reduce the value of the credit protection calculated under Article 110 by 40%;

2) where the amount that the protection provider has undertaken to pay is higher than the exposure value, the value of the credit protection shall not exceed 60% of the exposure value.

112. Where unfunded credit protection is denominated in a currency different from that in which the exposure is denominated, banks shall reduce the value of the credit protection by the application of a volatility adjustment as follows:

$$\mathbf{G^* = G \bullet (1 - H_{fx})}$$

where:

G^* = the amount of credit protection adjusted for foreign exchange risk;

G = the nominal amount of the credit protection;

H_{fx} = the volatility adjustment for any currency mismatch between the credit protection and the underlying obligation determined in accordance with Article 113. Where there is no currency mismatch, H_{fx} is equal to zero.

113. Banks shall base the volatility adjustments for any currency mismatch on a 10 business day liquidation period, assuming daily revaluation, and may calculate them based on the Supervisory Volatility Adjustments approach as set out in Section 6 of Chapter VIII. Banks shall scale up the volatility adjustments in accordance with Section 7 of Chapter VIII.

Section 2
Calculating risk-weighted exposure amounts under the standardised approach

114. For the purposes of the Regulation No 111/2018 banks shall calculate the risk-weighted exposure amounts in accordance with the following formula:

$$\mathbf{\max\{0, E - G_A\} \bullet r + G_A \bullet g}$$

where:

E = the exposure value in accordance with the above-mentioned Regulation; for this purpose, the exposure value of an off-balance sheet item shall be 100% of its value rather than the exposure value indicated in that Regulation;

G_A = the amount of credit risk protection, as calculated under Article 112, (G^*) further adjusted for any maturity mismatch as laid down in Title V;

r = the risk weight of exposures to the obligor as specified under the Regulation No 111/2018;

g = the risk weight of exposures to the protection provider as specified under the Regulation No 111/2018.

115. Where the protected amount (G_A) is less than the exposure (E), banks may apply the formula specified in Article 114 only where the protected and unprotected parts of the exposure are of equal seniority, i.e. the bank and the guarantor share the losses proportionally.

116. Banks may extend the preferential treatment of exposures to central governments or central banks set out in the Regulation No 111/2018 to exposures or parts of exposures guaranteed by the central government or central bank, where the guarantee is denominated in the domestic currency of the borrower and the exposure is funded in that currency.

TITLE V
MATURITY MISMATCHES

Chapter X
CREDIT PROTECTION ELIGIBILITY REQUIREMENTS IN THE EVENT OF MATURITY MISMATCH

117. For the purpose of calculating risk-weighted exposure amounts, a maturity mismatch occurs when the residual maturity of the credit protection is less than that of the protected exposure.

118. Where protection has a residual maturity of less than three months and the maturity of the protection is less than the maturity of the underlying exposure, that protection does not qualify as eligible credit protection.

119. Where there is a maturity mismatch, the credit protection shall not qualify as eligible where the original maturity of the protection is less than 1 year.

Chapter XI
MATURITY OF CREDIT PROTECTION

120. Subject to a maximum of five years, the effective maturity of the underlying shall be the longest possible remaining time before the obligor is scheduled to fulfil its obligations.

121. Subject to Articles 122 and 123, the maturity of the credit protection shall be the time to the earliest date at which the protection may terminate or be terminated.

122. Where there is an option to terminate the protection, which is at the discretion of the protection seller, banks shall take the maturity of the protection to be the time to the earliest date at which that option may be exercised.

123. Where there is an option to terminate the protection, which is at the discretion of the protection buyer, and the terms of the arrangement at origination of the protection contain a positive incentive for the bank to call the transaction before contractual maturity, a bank shall take the maturity of the protection to be the time to the earliest date at which that option may be exercised; otherwise the bank may consider that such an option does not affect the maturity of the protection.

124. Where a credit derivative is not prevented from terminating prior to expiration of any grace period required for a default on the underlying obligation to occur as a result of a failure to pay, banks shall reduce the maturity of the protection by the length of the grace period.

Chapter XII
VALUATION OF PROTECTION

125. For transactions subject to funded credit protection under the Financial Collateral Simple Method, where there is a mismatch between the maturity of the exposure and the maturity of the protection, the collateral does not qualify as eligible funded credit protection.

126. For transactions subject to funded credit protection under the Financial Collateral Comprehensive Method, banks shall reflect the maturity of the credit protection and of the exposure in the adjusted value of the collateral according to the following formula:

$$C_{VAM} = C_{VA} \cdot \frac{t - t^*}{T - t^*}$$

where:

C_{VA} = the volatility adjusted value of the collateral as specified in Article 87 or the amount of the exposure, whichever is lower;

t = the number of years remaining to the maturity date of the credit protection calculated in accordance with Chapter XI, or the value of T, whichever is lower;

T = the number of years remaining to the maturity date of the exposure calculated in accordance with Chapter XI, or five years, whichever is lower;

$t^* = 0{,}25$.

Banks shall use C_{VAM} as C_{VA} further adjusted for maturity mismatch in the formula for the calculation of the fully adjusted value of the exposure (E*) set out in Article 92.

127. For transactions subject to unfunded credit protection, banks shall reflect the maturity of the credit protection and of the exposure in the adjusted value of the credit protection according to the following formula:

$$G_A = G^* \cdot \frac{t - t^*}{T - t^*}$$

where:

G_A = G^* adjusted for any maturity mismatch;

G^* = the amount of the protection adjusted for any currency mismatch;

t = is the number of years remaining to the maturity date of the credit protection calculated in accordance with Chapter X, or the value of T, whichever is lower;

T = is the number of years remaining to the maturity date of the exposure calculated in accordance with Chapter XI, or five years, whichever is lower;

$t^* = 0{,}25$.

Banks shall use G_A as the value of the protection for the purposes of Chapter IX.

TITLE VI
BASKET CREDIT RISK MITIGATION TECHNIQUES

Chapter XIII
FIRST-TO-DEFAULT CREDIT DERIVATIVES

128. Where a bank obtains credit protection for a number of exposures (basket of exposures) under terms that the first default among the exposures shall trigger payment and that this credit event shall terminate the contract, the bank may amend the calculation of the risk-weighted exposure amount which would, in the absence of the credit protection, produce the lowest risk-weighted exposure amount in accordance with the Regulation No 111/2018.

129. The treatment set out in this Chapter applies only where the exposure value is less than or equal to the value of the credit protection.

Chapter XIV
NTH-TO-DEFAULT CREDIT DERIVATIVES

130. Where the nth default among the exposures (basket of exposures) triggers payment under the credit protection, the bank purchasing the protection may only recognise the protection for the calculation of risk-weighted exposure amounts where protection has also been obtained for defaults 1 to n-1 or when n-1 defaults have already occurred. In such cases, the bank may amend the calculation of the risk-weighted exposure amount, which would, in the absence of the credit protection, produce the n-th lowest risk-weighted exposure amount in accordance with this Regulation. Banks shall calculate the risk-weighted exposure amount as specified in the Regulation No 111/2018.

131. The treatment set out in this Chapter applies only where the exposure value is less than or equal to the value of the credit protection.

132. All exposures in the basket shall meet the requirements laid down in Articles 40, 41 and paragraph (4) of Article 62 of this Regulation.