Ordinance No. 8
of 14 December 2006
on the Capital Adequacy of Credit Institutions

(Adopted by the Bulgarian National Bank, published in the Darjaven Vestnik, issue 106 of 27 December 2006, in force as of 1 January 2007; amended, issue 62 of 2007; amended, issue 38 of 2008, effective as of 11April 2008; amended, issue 21 of 2009; amended, issues 20, 85 and 102 of 2010; amended, issue 95 of 2011)

Part One
GENERAL PROVISIONS AND PRUDENTIAL REQUIREMENTS

Chapter One
GENERAL PROVISIONS

Article 1. (1) This Ordinance lays down the minimum amount, elements and structure of own funds of credit institutions and the minimum capital requirements for the risks taken by credit institutions and disclosure requirements.

(2) The provisions herein shall be applied on a non-consolidated and consolidated basis.

(3) Every credit institution shall:

1. introduce and implement sound control systems covering the management of risk, reporting and the capital adequacy assessment process;

2. hold at any time own funds corresponding to the overall risk profile of the credit institution.

Chapter Two
PRUDENTIAL REQUIREMENTS

Section One
OWN FUNDS (CAPITAL BASE)

Elements of Own Funds

Article 2. The own funds of a bank on a non-consolidated basis shall be formed from the sum of tier-one capital (initial capital) and tier-two capital (supplementary capital), less the amounts in Article 6.

Tier-one Capital (Initial Capital)

Article 3. (1) Tier-one capital shall comprise the following elements:

1. (amended; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) registered and paid-up capital which fully absorbs losses in going concern situations, and in the event of bankruptcy or liquidation it is paid after all other claims;

2. "Reserve" fund within the meaning of Article 246 of the Law on Commerce, with the exception of premium reserve related to cumulative preferred stock;

3. other reserves for general purposes formed out of the profit after paying the profit tax due;

4. retained earnings from previous years;

5. (new; Darjaven Vestnik, issue 38 of 2008, effective as of 11 April 2008) interim profit, reduced by taxes due, any foreseeable dividend payments and other allowances;

6. (new; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) instruments under Article 3a.

(2) (amended; Darjaven Vestnik, issue 38 of 2008; amended; Darjaven Vestnik, issue 20 of 2010) Prior to the decision taken at the shareholders' general meeting the profit from the previous year, reduced by taxes due and confirmed by the specialised auditing companies of the bank may be included in the own funds after a deduction of the amounts of foreseeable dividend payments and other allowances.

(3) Once included as part of tire-one capital, retained earnings from previous years can be used for dividends only after approval by BNB.

(4) (new; Darjaven Vestnik, issue 38 of 2008, effective as of 11 April 2008) The profit under paragraph 1, item 5 may be included in own funds only if the following requirements are met:

1. (amended; Darjaven Vestnik, issue 20 of 2010) a maximum amount of foreseeable dividend payments and other allowances is set;

2. (amended; Darjaven Vestnik, issue 20 of 2010) profits and taxes due are confirmed by the specialised auditing company of the bank following a procedure set by the BNB;

3. a notification accompanied by documents about the circumstances mentioned in items 1 and 2 has been sent to the BNB and the BNB has not made objections in a ten-day period after their submission or the submission of additional documents if such were asked for.

(5) (new; Darjaven Vestnik, issue 38 of 2008, effective as of 11 April 2008; amended, Darjaven Vestnik, issue 20 of 2010) Where the interim profit by the end of the reporting period is lower than the value of the income recognised under paragraph 4, only the lowest value shall be included in the own funds.

(6) (former paragraph 4; Darjaven Vestnik, issue 38 of 2008, effective as of 11 April 2008) The amount under paragraph 1 shall be reduced by:

1. losses for the current and previous years;

2. the book value of the credit institution's own shares;

3. the amount of intangible assets;
4. unrealised loss from financial instruments available for sale;
5. (new; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) value adjustments of the instruments made in their assessment under Articles 17 and 18.

(7) (former paragraph 5; Darjaven Vestnik, issue 38 of 2008, effective as of 11 April 2008) Where a bank is a securitisation initiator, the amount under paragraph 1, item 4 shall be reduced by the net profit, which arises from the capitalisation of future incomes from securitised assets and ensures a credit facility.

Requirements to the Instruments Recognised as Tire-one Capital

Article 3a. (new; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) (1) Tier-one capital shall comprise also undated instruments, which meet the following requirements:

1. the provisions governing the instrument shall allow the credit institution to cancel, where necessary, the payments of interest or dividends for an unlimited period of time, on a non-cumulative basis; the credit institution shall cancel such payments if it does not comply with the capital requirements set out in Article 7;
2. (amended; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) the provisions governing the instrument shall provide for the principal, unpaid interest or dividend to be such as to absorb losses and to not hinder the recapitalisation of the credit institution through appropriate mechanisms elaborated by the European Banking Authority;
3. in the event of bankruptcy or liquidation of the credit institution, the instruments shall rank after the instruments referred to in Article 4, paragraph 2, items 2 and 3;
4. all other requirements set out in Article 4, paragraph 2, item 2 are met.

(2) The instruments under paragraph 1 may include one or more call options at the sole discretion of the issuer, but they shall not be redeemed not earlier than five years from the date of the issue.

(3) If the provisions governing the instruments provide for a moderate incentive for the credit institution to redeem as determined by the BNB, such incentive shall not occur within ten years of the date of issue.

(4) The instruments may be called or redeemed only with the prior written permission of the BNB provided the request is made at the initiative of the credit institution and either financial situation or capital adequacy of the credit institution are not unduly affected. In such a case, the BNB may require the credit institution to replace the instruments by instruments under paragraph 1 of the same or better quality or by shares under Article 3, paragraph 1, item 1.

(5) The Bulgarian National Bank may require the cancellation of the payments under paragraph 1, item 1 based on the financial situation and capital adequacy of the credit institution. Any such cancellation shall not prejudice the right of the credit

institution after appropriate notification to the BNB to substitute the payment of interest or dividend by a payment in the form of the shares under Article 3, paragraph 1, item 1, provided that any such mechanism allows the credit institution to preserve financial resources and if the BNB has not objected within seven days.

(6) The Bulgarian National Bank may grant permission for call or redemption of instruments under paragraph 1 in the event that there is a change in the applicable tax or supervisory treatment of such instruments which was unforeseen at the date of issue.

(7) The instruments under paragraph 1 may be included in tier-one capital upon a permission of the BNB based on a written application accompanied by the relevant documents proving compliance with the requirements under this Article. The deadline for taking a decision is 30 days.

Tier-two Capital (Supplementary Capital)

Article 4. (1) Tier-two capital shall comprise the elements under paragraph 2, which meet the following requirements:

1. funds that are entirely at the disposal of the bank to cover normal banking risks when capital losses are not yet identified;
2. availability of these funds shall be recorded in accounting registers of the bank;
3. their amount is determined by the competent management body of the bank and verified by an independent external auditor;
4. the BNB is informed and may conduct supervision over their availability and utilisation.

(2) Tier-two capital shall comprise the following elements:

1. revaluation reserves for the real estate occupied by the bank;
2. the amounts attracted by the bank in permanent debt/capital (hybrid) instruments and other financial instruments, including permanent cumulative preferential shares, provided that these instruments meet the following specific requirements:

a) the amounts on them are fully paid;

b) their repayment is not limited by a term;

c) their repayment is not guaranteed in any form by the bank;

d) in case of liquidation or insolvency of the bank, the repayment of these funds is admissible after all other creditors' claims have been satisfied;

e) claims on these instruments as regards the principal may not be collectable without the permission of the BNB in writing;

f) the terms under which the bank has attracted these funds entitle the credit institution to defer repayment of interest income on them in case the credit institution has not generated profit or the profit is insufficient;

3. the amounts attracted as a subordinated term debt as well as term cumulative preferential shares and subordinated term debt-equity (hybrid) instruments, provided that they meet the following specific requirements:

a) the amounts on the instruments are fully repaid;

b) their repayment is not guaranteed in any form by the bank;

c) their original term to maturity is at least 5 years;

d) the instruments may not be repaid ahead of term without the permission of BNB in writing;

e) the contract may not provide for a possibility for the collection of the debt in advance;

f) in case of liquidation of the bank, the repayment of the debt is admissible after all other creditors' claims have been satisfied.

(3) During the last 5 years to maturity, the amount of the instruments under item 3 shall be included in the tier-two capital reduced by 20 percent for each year. After the instruments had matured, they will be entirely excluded from own funds (capital base) calculation.

(4) The previous paragraph applies also for the dates of interest and other agreed incomes repayment on the instruments under item 3.

(5) The amounts under Article 2, items 2 and 3 may be included in tier-two capital upon a permission of the Deputy Governor heading the Banking Supervision Department based on a written application accompanied by the relevant documents proving compliance with the requirements under this Article. The deadline for taking a decision is 30 days.

(6) Banks shall not include in their own funds:

1. reserves from cash flow hedges of positions previously measured at amortised cost and cash flow hedges related to forecasted transactions;

2. gains or loss on liabilities valued at fair value due to changes in the bank's credit quality rating;

3. unrealised gain from investment property and from financial instruments available for sale.

Section Two

LIMITS AND REDUCTIONS IN ESTABLISHING THE AMOUNT OF OWN FUNDS

Limits in Establishing the Amount of Own Funds

Article 5. (1) Tier-two capital shall not exceed tier-one capital.

(2) Tier-two capital under Article 4, paragraph 2, item 3 shall not exceed 50% of tier-one capital.

(3) (new; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) The total of the items under Article 3, paragraph 1, item 6 shall be subject to the following limits:

1. instruments that must be converted during emergency situations and may be converted at the initiative of the BNB, at any time, based on the financial situation and capital adequacy of the issuer into items referred to in Article 3, paragraph 1,

item 1 within a predetermined range must in total not exceed a maximum of 50% of tier-one capital;

2. all other instruments must not exceed a maximum of 35% of tier-one capital, and together with the instruments under paragraph 1 – 50%;

3. instruments with provisions that provide for an incentive for the credit institution to redeem them must not exceed:

a) 15% of tier-one capital;

b) together with the instruments under item 2 – 35%; and

c) together with the instruments under items 1 and 2 – 50%.

Reductions in Establishing the Amount of Own Funds

Article 6. (1) The own funds shall be reduced by:

1. the book value of investments in shares or in other form of participating interests amounting to more than 10% of the paid-in capital of a bank or other financial institution under the Law on Credit Institutions, as well as the investments in debt-equity (hybrid) instruments and in subordinated term debt in such institutions, in which the bank holds more than 10% of the paid-in capital for each individual case where they are not consolidated in its balance sheet;

2. the net book value of investments in shares or in other form of participating interests in the capital, in debt-equity (hybrid) instruments and in subordinated term debt in another bank or other financial institutions under the Law on Credit Institutions, where their total amount exceeds 10% of the bank's own funds prior to the reductions under this Article;

3. the net book value of the investments in shares or another form of direct or indirect participation of insurance undertakings, reinsurance undertakings and insurance holding companies, when they present 20 or more than 20% of the registered and paid-in capital;

4. the net book value of investments in shares or in other form of participating interests, which represent 10 or more than 10% of the paid-in capital of a unconsolidated undertakings other than those under item 1;

5. (new; Darjaven Vestnik, issue 38 of 2008, effective as of 11 April 2008) where the bank uses Standardised Approach for credit risk, the amount of specific provisions for credit risk under Ordinance No. 9 of 2008 of the BNB on the Evaluation and Classification of Risk Exposures of Banks and Allocation of Specific Provisions for Credit Risk (Ordinance No. 9 of 2008);

6. (former item 5; Darjaven Vestnik, issue 38 of 2008, effective as of 11 April 2008) where the bank uses Internal-Rating Based Approach for credit risk, the expected loss for capital positions, calculated as per Article 71, paragraphs 6 and 7 and the excess of the expected loss amounts over the specific provisions for exposures to corporates under Article 72;

7. (former item 6; Darjaven Vestnik, issue 38 of 2008, effective as of 11 April 2008; amended; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December

2011) the amount of securitisation positions determined for deduction as set out in Chapter Seven Securitisation Framework, including when they are part of the trading book.

(2) The amounts under paragraph 1 shall be reduced at a 50% ratio from tier-one capital and 50% from tier-two capital and where the respective reduction exceeds tier-two capital then that excess shall be reduced from tier-one capital.

(3) The own funds on a consolidated basis shall be formed pursuant to Article 2 by adding, deducting respectively, the following elements:

1. minority interests;
2. reputation;
3. balances resulting from translation differences;
4. other elements provided by the effective legislation in case of consolidation.

(4) (amended; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) Where the items under paragraph 3, items 2, 3 and 4 are positive (debit) items, they shall be deducted in the calculation of consolidated own funds. Where they are negative (credit) items, they shall be added to consolidated tier-one capital. Minority interests under Article 3, item 1, including those resulting from instruments under Article 3, paragraph 1, item 6 in subsidiary banking and non-banking undertakings, which are subject to full consolidation, shall be reported under the respective capital item of the bank subject to the nature of minority interests.

(5) The reductions of the capital base under paragraphs 1 and 3 are not involved in the calculation of capital requirements.

Section Three

MINIMUM AMOUNT OF OWN FUNDS

Article 7. Banks shall maintain own funds, which shall at any time exceed or equal the sum of the following capital requirements, multiplied by 1.5:

1. credit risk and dilution risk in respect of the banking book business;
2. (amended; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) position risk in respect of the trading book business;
3. (amended; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) counterparty risk and settlement risk in respect of the overall business;
4. foreign-exchange risk and commodity risk in respect of the overall business;
5. operational risk in respect of the overall business.
6. additional capital requirement under Article 11, paragraph 4.

Section Four

SPECIFIC REQUIREMENTS FOR THE ELECTRONIC MONEY INSTITUTIONS

(repealed; Darjaven Vestnik, issue 85 of 2010, effective as of 30 April 2011)

Own Funds

Article 8. (repealed; Darjaven Vestnik, issue 85 of 2010, effective as of 30 April 2011)

Investments Requirements

Article 9. (repealed; Darjaven Vestnik, issue 85 of 2010, effective as of 30 April 2011)

Applicability

Article 10. (repealed; Darjaven Vestnik, issue 85 of 2010, effective as of 30 April 2011)

Section Five

SUPERVISORY REVIEW AND INTERNAL ANALYSIS OF CAPITAL

Article 11. (1) The supervisory review under Article 79 of the Law on Credit Institutions shall include:

1. the levels of credit, market and operational risks taken by the bank;
2. the results of the stress testing;
3. the level of the interest rate risk in the banking book;
4. the level and management of liquidity risk;
5. the level and management of concentration risk and large exposures;
6. the robustness, suitability and manner of application of the policies and procedures implemented by the bank for the management of the residual risk associated with the use of recognised credit risk mitigation techniques;
7. the extent to which the own funds held by a bank in respect of assets which it has securitised are adequate having regard to the economic substance of the transaction, including the degree of risk transfer achieved;
8. the impact of diversification effects and how such effects are factored into the risk measurement system;
9. any implicit support provided to a securitisation;
10. (amended; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) the appropriateness of the valuation adjustments under Article 17 and the time period under Article 18, paragraph 2, item 1 with a view to prevent incurring material losses if positions are closed within a short period under normal market conditions.

(2) A bank shall regularly carry out an internal analysis of the amounts, types and distribution of capital that it considers adequate to cover the nature and level of all risks to which it is or might be exposed (internal capital), by having in place sound, effective and complete strategies and processes.

(3) The strategies and processes under paragraph 2 shall be subject to regular internal review to ensure that they remain comprehensive and proportionate to the nature, scale and complexity of the activities of the bank.

(4) When the supervisory review finds out that the strategies and processes under paragraph 2 are not sound, the BNB may impose an additional capital requirement on the bank.

Section Six
BANKING (NON-TRADING) AND TRADING BOOK

Definition for Banking and Trading Book

Article 12. (1) For calculation of capital requirements for credit and market risk banks shall differentiate all their positions between trading and banking book.

(2) A banking book shall include on- and off-balance sheet positions, which are not qualified as positions in a trading book.

(3) Systems shall be implemented to evaluate and manage the risk arising from potential changes in interest rates as they affect a bank's activities in a banking book.

(4) The trading book shall consist of all positions in financial instruments and commodities, which the bank holds either with trading intent or in order to hedge other elements of the trading book. It does not include instruments and commodities, which can not be hedged or their tradability is restricted by covenants.

(5) Positions held with trading intent are the positions of a bank in financial instruments and commodities, which are held for short-term resale or for benefiting from differences between their buying and selling prices arising from actual or expected short-term market price variations. These positions shall include proprietary positions and positions arising from client servicing and market making.

(6) (new; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) The requirements of Articles 14–18 shall also apply to the bank's positions which are measured at fair value and are included in the banking book.

Trading Intent

Article 13. Positions or sub-portfolios held with trading intent shall comply with the following requirements:

1. there must be a clearly documented trading strategy for the respective positions or sub-portfolios, approved by competent management body of the bank, which shall include expected holding horizon;

2. clearly defined rules and procedures for the active management of these positions, which shall include the following:

a) positions entered into on a trading desk;

b) position limits are set on a position-by-position basis, which are monitored for appropriateness;

c) dealers have the autonomy to enter into or manage the positions within agreed limits and according to the approved strategy;

d) positions are reported to the competent management bodies as an integral part of the bank's risk management process;

e) positions are actively monitored with reference to market information sources and an assessment is made of the marketability or hedge ability of the position or its component risks, including the assessment, quality and availability of market inputs to the valuation process, level of market turnover and sizes of positions traded in the market;

3. there are clearly defined rules and procedures to monitor the position against the bank's trading strategy including the monitoring of turnover and individual positions in the trading book.

Systems and Controls

Article 14. Banks shall establish and maintain systems and controls sufficient to provide prudent and reliable valuation estimates with respect to the trading book. Systems and controls shall include at least the following elements:

1. (amended; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) documented policies and procedures for the process of valuation, including clearly defined responsibilities of the various areas involved in the determination of the valuation, sources of market information and review of their appropriateness, guidelines for the use of unobservable inputs reflecting the bank's assumptions of what market participants would use in pricing the position, frequency of independent valuation, timing of closing prices, procedures for adjusting valuations, month end and ad-hoc verification procedures;

2. clearly defined and independent reporting lines between the department responsible for the valuation process and the relevant person from the competent management body of the bank.

Marking to Market Method

Article 15. (1) (amended; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) Marking to market is the at least daily valuation of positions at readily available close out prices that are sourced independently, such as exchange prices, screen processor quotes from independent reputable brokers. The bank shall use this method where possible.

(2) When marking to market the more conservative of bid/offer shall be used unless the bank is a significant market maker in the particular type of financial instrument or commodity, which can close out at mid market price.

Marking to Model

Article 16. (1) (amended; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) Where marking to market is not possible, banks shall conservatively mark to model their positions and portfolios. Marking to model is any valuation which has to be benchmarked, extrapolated or otherwise, calculated from market inputs.

(2) Marking to model shall comply with the following requirements:

1. (amended; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) the competent management body of the bank shall be aware of the elements of the trading book or of other fair-valued positions which are subject to mark to model and shall understand the level of uncertainty this creates in the reporting of the risk performance and profitability of the business;

2. market inputs shall be sourced, where possible, in line with market prices, and the appropriateness of the market inputs and the parameters applied shall subject to regular review;

3. where available, valuation methodologies which are accepted market practice for particular financial instruments or commodities shall be used;

4. where the model is developed by the bank itself, it shall be based on appropriate assumptions, which have been approved by suitably qualified parties independent of the development process; the model shall be developed and approved independently from the trading department and shall be subject to independent review to validate the numerical methods, assumptions and software implementation;

5. there shall be formal change control procedures in place and a secure copy of the model shall be held to periodically check valuations;

6. the risk management unit shall be aware of the weaknesses of the models used and how best to reflect those in the valuation output;

7. the model shall be subject to periodic review to determine the appropriateness of its usage.

(3) To verify valuations, an independent periodic review shall be held at least once monthly to determine the accuracy and independence of market prices or model inputs.

Valuation Adjustments

Article 17. (1) Where independent pricing sources are not available or pricing sources are more subjective, valuation adjustments under Article 16 shall be made for which the banks shall adopt and maintain procedures.

(2) Banks shall consider the following valuation adjustments by:

1. unrealised credit spreads;
2. close-out costs;
3. operational risks;
4. ahead of term termination;
5. investing and funding costs;

6. future administrative costs; and
7. model risk.

Valuation Adjustments for Less Liquid Positions

Article 18. (amended; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) (1) Banks shall establish and maintain procedures for calculating and adjustment to the current valuation of less liquid positions due to market events or problematic situations for the bank (concentrated positions, stale positions). Such adjustments shall where necessary be in addition to any changes to the value of position required for financial reporting purposes and shall be designed to reflect the illiquidity of the position.

(2) Banks shall consider several factors when determining whether a valuation adjustment is necessary for less liquid positions:

1. the amount of time it would take to hedge out the position/risks within the position;
2. the volatility and average values of bid/offer spreads;
3. the availability of market quotes (number and identity of market makers);
4. the volatility and average values of trading volumes, including in case of market shocks;
5. market concentrations;
6. “ageing” of positions;
7. extent of employing a model and the impact of risks related to that model;
8. third-party valuations or marking to model.

(3) Banks shall conduct periodic reviews of the suitability of adjustments.

(4) With regard to complex products including securitisation exposures and n-th-to-default credit derivatives, banks shall explicitly assess the need for valuation adjustments to reflect the model risk associated with using a possibly incorrect valuation methodology and the model risk associated with using unobservable (and possibly incorrect) calibration parameters in the valuation model.

Internal Hedges

Article 19. (1) An internal hedge is a position that completely or materially offsets the risk of a banking book position(s).

(2) An internal hedge position is eligible for trading book treatment provided it is held with trading intent and the general criteria on trading intent and prudent valuation specified in Article 14 – 17 are satisfied and meet the following conditions:

1. the position shall not be primarily intended to avoid or reduce capital requirements;
2. internal hedges shall be properly documented and subject to internal approval and audit procedures;
3. the transactions, related to internal hedges shall be dealt with at market conditions;

4. market risk that is generated by the internal hedge shall be dynamically managed in the trading book within the authorised limits;

5. the transactions, related to internal hedges shall be monitored based on appropriate procedures.

(3) The hedged risks in the banking book shall be treated as trading book risks and shall be included in the calculation of the capital requirements for the trading book.

(4) (amended; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) When a bank hedges non-trading book credit exposures using an internal hedge, the banking book exposure is not deemed to be hedged unless the bank purchases a credit derivative from a third party protection provider and the derivative meets the requirements set out in Article 149, paragraphs 2 – 6. Where such protection is purchased from a third party, the internal hedged exposure and the credit derivative shall be excluded from the calculation of the capital requirements for the trading book, excluding the cases where Article 232, paragraph 5 is applied.

Eligibility for Inclusion in the Trading Book

Article 20. (1) Banks shall have clearly defined rules and procedures for overall management of the trading book, which shall address at a minimum the following:

1. criteria for determining the exposures and the activities in the trading book;

2. the extent to which an exposure can be marked-to-market daily by reference to an active and liquid market;

3. for positions marked-to-model, the extent to which the bank can:

a) identify all material risks;

b) hedge all material risks with instruments for which an active liquid market exists; and

c) derive reliable estimates for the key assumptions and parameters used in the model.

4. the extent to which the valuations can be validated externally in a consistent manner;

5. taking account of legal restrictions or other operational requirements that impede the bank's ability to effect a liquidation or hedge of the position in the short term;

6. the extent to which the bank can, and is required to, actively manage its risk exposures;

7. circumstances and criteria under which the bank may transfer risk or positions between the banking and trading books.

(2) The rules and procedures under paragraph 1 shall be documented and shall be subject to periodic internal audit.

(3) Trading-related repos, which the bank accounts for in its banking book may be included in the trading book for capital requirements purposes so long as all such repo-style transactions are treated in the same manner. The types of trading-related

repo transactions that meet the requirements of Article 12, paragraph 5 and Article 13, of which both legs are in the form of either cash or instruments includable in the trading book. Regardless of where they are booked, all repo-style transactions are subject to a capital requirement for counterparty credit risk.

Derogation from Calculating Capital Requirements for Market Risk in the Trading Book

Article 21. (1) Banks may calculate the capital requirements for their trading book instruments in accordance with the requirements applied to the banking book where all of the following conditions are in place:

1. the trading book business does not normally exceed 5% and never exceeds 6% of their total business;

2. the trading book positions do not normally exceed BGN 30 million and never exceed BGN 40 million.

(2) The size of the trading book business shall be the sum of the short and long positions (on- and off-balance sheet) held in the trading portfolio regardless of their sign. The size of the overall business shall be the sum of all on-balance sheet assets and off-balance sheet items.

(3) Within the meaning of paragraph 1, it shall be considered normal where a bank does not exceed more than three times in a month the limit of 5% and BGN 30 million while it does not reach the 6% and BGN 40 million limit.

(4) A bank which exceeds the limit of 5% or BGN 30 million more than three times in a month, but yet has not reached the 6% or BGN 40 million limit shall notify the BNB within three business days following the end of the reporting month, of its daily and average monthly amounts of its trading book transactions and their total amount as a percentage of its overall business. The notification shall also include explanation for exceeding the limit.

(5) Within 10 days from receipt of notification the BNB shall notify the bank whether and from which date it must start calculating capital requirements for market risk for its trading book business.

(6) A bank which exceeds the limit of 6% and BGN 40 million shall notify the BNB thereof and of the reasons for exceeding the limit not later than the day following it.

(7) The Bulgarian National Bank shall determine the date from which the bank shall start calculating capital requirements for the market risk in its trading book business.

(8) Capital requirements for foreign exchange risk and commodities risk shall be applied regardless of the fact that the bank falls within the derogation of paragraph 1.

Section Seven

CALCULATION OF CAPITAL ADEQUACY

Capital Adequacy Ratio

Article 22. (1) A bank shall establish the capital adequacy ratio as a proportion between its own funds and its risk weighted assets.

(2) The bank shall establish the adequacy ratio of tier-one capital as a proportion between tier-one capital and risk weighted assets.

(3) Risk weighted assets shall be the amount of risk weighted assets for credit risk, market risk and operational risk.

1. the risk weighted assets for credit risk shall consist of:

a) risk weighted assets for credit risk and dilution risk in banking book;

b) risk weighted assets for counterparty risk in the overall business;

c) (amended; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) risk-weighted assets for settlement risk in the overall business.

2. the risk weighted assets for market risk shall consist of:

a) risk weighted assets for market risk in the trading book;

b) risk weighted assets for foreign exchange risk in the overall business;

c) risk weighted assets for commodity risk in the overall business.

3. the risk weighted assets for operational risk shall be calculated for the overall business of the bank.

(4) The overall capital adequacy ratio may not be less than 12%.

(5) Tier-one capital adequacy ratio may not be less than 6%.

(6) The equivalence of the risk weighted assets under paragraph 3, item 1 "c", items 2 and 3 shall be calculated by multiplying the capital requirement for the respective risk by 12.5.

(7) The overall capital adequacy ratio and tier-one capital adequacy ratio shall be complied with on both non-consolidated and consolidated basis.

PART II

CAPITAL REQUIREMENTS FOR CREDIT RISK

Chapter Three

CREDIT RISK – GENERAL PROVISIONS

Article 23. (1) To calculate risk weighted assets for credit risk, the bank shall use the Standardised Approach under Articles 24 – 56 or, with the BNB's approval, the Internal Ratings Based Approach under Articles 57 – 126.

(2) For the purpose of this Part, exposures to investment firms which are established in third countries, subject to equivalent supervision, as well as recognised exchange and recognised clearing houses shall be treated as exposures to institutions.

Chapter Four
STANDARDISED APPROACH

Section One
AMOUNT OF RISK EXPOSURES

Article 24. (1) For the purpose of calculating the capital requirements for credit risk under the Standardised Approach, banks shall establish the amount of their risk weighted on- and off-balance sheet items.

(2) Banks that apply capital requirements for their trading book positions for market risk shall establish the amount of their credit risk exposures by multiplying their banking book positions by the relevant risk weights given in this Chapter according to the external credit rating for each asset or respective bearer.

(3) For the banks under paragraph 2 the risk weighted assets for credit risk shall include:

1. banking book positions;
2. off-balance sheet items equalised to the assets under item 1;
3. non-exchange traded (over-the-counter) derivatives weighted for counterparty risk;
4. trading book positions weighted for counterparty risk and for settlement risk.

(4) Banks that do not apply capital requirements for their trading book positions for market risk shall calculate the amount of their credit risk exposures by means of including their trading book positions under their banking book positions multiplied by the respective conversion factors and risk weights specified in this Chapter in accordance to the external credit rating for each asset or respective bearer.

(5) For banks under paragraph 4 the risk weighted assets for credit risk shall include:

1. banking book and trading book positions;
2. off-balance sheet positions equalised to the assets under item 1;
3. non-exchange traded (over-the-counter) derivatives weighted for counterparty risk.

(6) Where the on- and off-balance sheet positions have credit protection, the relevant lower risk weights shall be applied for the secured portion according to the external credit rating of the guarantor or the pledged asset in keeping with the principles set forth in Chapter Six *Credit Risk Mitigation*.

(7) The capital requirement under the standardised approach for credit risk is 8%.

Section Two
EXPOSURE VALUE

General Provisions

Article 25. (1) (amended; Darjaven Vestnik, issue 38 of 2008, effective as of 11 April 2008) The value of an exposure shall be its on-balance sheet value, calculated according to the applicable accounting standards and adjusted by the specific provisions for credit risk under Ordinance No. 9 of 2008. The value of an off-balance sheet item shall be its equalised on-balance sheet amount obtained as a result of applying a conversion factor as per Appendix 2 *Off-balance Sheet Items*. The equalised off-balance sheet positions shall be assigned to asset categories as per Article 26, paragraph 1.

(2) The exposure value of a derivative instrument specified in Appendix 1 List of Derivatives shall be determined by using one of the methods in Chapter Eight *Treatment of Counterparty Credit Risk* by taking into account contracts of novation and other netting agreements in accordance with the same Chapter.

(3) Where an exposure is subject to a funded credit protection, the exposure value may be modified in accordance with Chapter Six *Credit Risk Mitigation* of this Part.

(4) Where an exposure takes the form of securities of commodities sold, posted or lent under a repurchase agreement or under a lending or borrowing agreement and in applying a comprehensive approach to calculate the effect of financial collateral provided pursuant to Article 135, paragraph 1, a volatility adjustment shall be added to the exposure value in accordance with the requirements of Articles 163 – 172.

Exposure classes

Article 26. (1) Each exposure shall be assigned to one of the following exposure classes:

1. claims or contingent claims on central governments or central banks;
2. claims or contingent claims on regional governments or local authorities;
3. claims or contingent claims on administrative bodies and non-commercial undertakings;
4. claims or contingent claims on multilateral development banks;
5. claims or contingent claims on international organisations;
6. claims or contingent claims on institutions;
7. claims or contingent claims on corporates;
8. retail claims or contingent retail claims;
9. claims or contingent claims secured on real estate property;
10. (new; Darjaven Vestnik, issue 21 of 2009) past-due items;
11. (former item 10; amended, Darjaven Vestnik, issue 21 of 2009) items belonging to high-risk categories;

12. (former item 11; amended, Darjaven Vestnik, issue 21 of 2009) claims in the form of covered bonds;

13. (former item 12; amended, Darjaven Vestnik, issue 21 of 2009) securitisation positions;

14. (former item 13; amended, Darjaven Vestnik, issue 21 of 2009) short-term claims on institutions and corporates;

15. (former item 14; amended, Darjaven Vestnik, issue 21 of 2009) claims in the form of collective investment undertakings (hereinafter referred to as CIUs);

16. (former item 15; amended, Darjaven Vestnik, issue 21 of 2009) other items.

(2) To be eligible for the retail exposure class referred to in paragraph 1, item 8, an exposure shall meet the following conditions:

1. the exposure shall be either to a natural person or persons, or to a small or medium sized entity;

2. the exposure shall be one of a significant number of exposures with similar characteristics such that the risks associated with such lending are substantially reduced;

3. the total amount owed to the bank and the parent undertaking and its subsidiaries, including any past due exposure, by the obligor client or group of connected clients, shall not, to the knowledge of the bank, exceed BGN 500 000; the bank shall take reasonable steps to acquire this knowledge; the total amount of the obligation shall exclude claims or contingent claims secured on real estate collateral;

(3) The present value of retail minimum lease payments is eligible for the retail exposure class.

(4) Securities and commodities shall not be eligible for the retail exposure class.

Exposures Risk Weights

Article 27. (1) Banks shall calculate every risk exposure unless deducted from own funds, by applying risk weights based on the exposure class to which the exposure is assigned and, to the extent specified in Section Three *Risk Weights* of this Chapter, its credit quality. The credit quality of an exposure may be determined by reference to the credit assessments of nominated External Credit Assessment Institutions (ECAIs) or to credit assessments of nominated Export Credit Agencies (ECA).

(2) For the purposes of paragraph 1, certain ECAIs or ECAs shall be considered eligible when they meet all the following conditions:

1. they meet the requirements under Articles 49 – 52;

2. their credit assessments for the relevant class of exposures are consistent with the credit quality steps and included in a list approved by the BNB Deputy Governor in charge of the Banking Supervision Department.

(3) The risk weighted value of the exposure shall be calculated by multiplying the exposure value by the risk weight determined as per this Chapter.

(4) The amount of the risk weighted exposures to institutions shall be calculated by applying the method based on the Individual Assessment Method as per Article 33.

(5) Where an exposure is subject to credit protection, the applicable weight for that exposure may be modified in line with Chapter Six *Credit Risk Mitigation* of this Part.

(6) The risk weighted amount of securitised exposures shall be calculated in line with Chapter Seven *Securitisation Framework* of this Part.

(7) To all remaining exposures, for which this Section does not specify a different treatment, 100% risk weight shall apply.

Section Three
RISK WEIGHTS

Exposures to Central Governments and Central Banks

Article 28. (1) Exposures to central governments and central banks that are rated by an ECAIs included in the list approved by Deputy Governor heading the Banking Supervision Department shall receive a risk weight in line with the assignment of their credit assessment to one of the six grades under the credit quality scale in Table 1 of Appendix 3 *Standardised Approach to Credit Risk*.

(2) Exposures to the European Central Bank (ECB) shall be assigned a 0% risk weight.

(3) Exposures to Member States' central governments and central banks denominated and funded in the domestic currency of that central government and central bank shall be assigned a risk weight of 0%.

(4) Following an approval by BNB Banking Supervision, banks may use the risk weight to exposures to the central government or the central bank of a third country under the Law on Credit Institutions, provided that the competent authorities of a third country apply prudential arrangements equivalent to those applied in the Community and have assigned a risk weight, which is lower than that indicated in paragraph 1 to exposures in the domestic currency to their central government and central bank funded in the same currency.

(5) Exposures to Central Governments and Central Banks for which a credit assessment by a nominated ECAI is recognised for risk weighting purposes shall be assigned a risk weight according to Table 2 of Appendix 3 *Standardised Approach to Credit Risk*.

(6) For all other exposures to central governments or central banks 100% risk weight shall be applied.

Exposures to Regional Governments or Local Authorities

Article 29. (1) (new; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) Exposures to regional government and local authorities denominated and funded in the domestic currency of the relevant central government shall be assigned a risk weight of 20%.

(2) (former paragraph 1, amended; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) Exposures to regional governments or local authorities shall be risk weighted as exposures to institutions without applying preferential treatment for short-term exposures pursuant to Article 33, paragraphs 4 and 6 and Article 34, paragraph 1, unless where paragraph 1 applies.

(3) (former paragraph 2; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) Exposures to regional governments or local authorities shall be treated as exposures to central governments, in which jurisdiction they are situated, only where the credit quality assessment of the local authority is equivalent with the assessment to the central government while the local authority has revenue-raising powers and an institutional arrangement is in place the effect of which is to reduce the risk of default.

(4) (former paragraph 3, amended; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) The BNB shall periodically publish a list of the local authorities in power in Bulgaria to be risk weighted pursuant to paragraph 3.

(5) (former paragraph 4; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) Following approval by the BNB, banks may apply the risk weights to a third country's central government or central bank to exposures to regional governments or local authorities in that country, if the competent authorities of that third country apply prudential arrangements equivalent to those applied in the Community by treating exposures to regional government and local authorities as exposures to their central government.

Exposures to Administrative Bodies and Non-commercial Undertakings

Article 30. (1) Exposures to administrative bodies or non-commercial undertakings shall be assigned a 100% risk weight unless otherwise provided for in paragraphs 2 to 4.

(2) (amended; Darjaven Vestnik, issue 38 of 2008, effective as of 11 April 2008) Exposures to public sector entities may be treated as exposures to institutions without application of the preferential treatment for short-term exposures pursuant to Article 33, paragraphs 4 and 6 and Article 34, paragraph 1.

(3) (new; Darjaven Vestnik, issue 38 of 2008, effective as of 11 April 2008) Subject to a judgment by the BNB, an exposure to a domestic public sector entity may be treated as an exposure to the central government because of the availability of a guarantee by it.

(4) (new; Darjaven Vestnik, issue 38 of 2008, effective as of 11 April 2008) The BNB shall regularly publish a list of domestic public sector entities under paragraph 3.

(5) (former paragraph 3; Darjaven Vestnik, issue 38 of 2008, effective as of 11 April 2008) When the competent authorities of a Member State classify their exposures to public sector entities in that country as exposures to institutions or to the central government in whose jurisdiction they are established, the banks in the Republic of Bulgaria are allowed to risk weight in that manner without preferential treatment of short-term exposures pursuant to Article 33, paragraphs 4 and 6 and Article 34, paragraph 1.

(6) (former paragraph 4; Darjaven Vestnik, issue 38 of 2008, effective as of 11 April 2008) When the competent authorities of a third country apply prudential arrangements equivalent or more stringent than those of the Community and treat their exposures to public-sector entities in this country as exposures to institutions, and provided the competent authorities of other Member States allow the banks in their jurisdiction to risk weight the exposures to such undertakings as exposures to institution, the banks in the Republic of Bulgaria may apply the risk weights established in such manner upon approval by BNB Banking Supervision Department.

Exposures to Multilateral Development Banks

Article 31. (1) Exposures to international development banks shall be treated as exposures to institutions unless provided for otherwise in Article 33, paragraphs 2 – 5, without preferential treatment of short-term exposures within the meaning of Article 33, paragraphs 4 and 6 and Article 34, paragraph 1.

(2) Exposures to institutions from List 1 in Appendix 3 *Standardised Approach to Credit Risk* shall receive 0% risk weight.

(3) A risk weight of 20% shall be assigned to the portion of unpaid capital subscribed to the European Investment Fund. Banks shall apply 20% risk weight to the portion of unpaid capital subscribed to the European Investment Fund in proportion to the due unpaid capital subscribed.

Exposures to International Organisations

Article 32. Exposures to the international organisations in List 2 of Appendix 3 *Standardised Approach to Credit Risk* shall receive a 0% risk weight:

Exposures to Institutions

Article 33. (1) To determine the risk weight of exposures to institutions the Individual Assessment Method shall apply.

(2) (amended; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) When applying the method under paragraph 1, exposures to institutions with a residual maturity of above 3 months shall be assigned risk weight in accordance with

the credit quality assessment as per Table 3 of Appendix 3 *Standardised Approach to Credit Risk*.

(3) (amended; Darjaven Vestnik, issue 21 of 2009) Exposures to institutions without assigned credit assessments shall receive a 50% risk weight.

(4) (amended; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) Exposures with a residual maturity of up to 3 months shall receive a risk weight in accordance with Table 4 of Appendix 3 *Standardised Approach to Credit Risk*.

(5) (amended; Darjaven Vestnik, issue 21 of 2009) Unrated exposures to institutions with an original effective maturity of up to 3 months and without assigned credit assessments shall receive a 20% risk weight.

(6) Exposures for which a short-term credit assessment is not available and which have a residual term to maturity of up to 3 months shall receive a risk weight in accordance with paragraph 4.

(7) An exposure for which a short-term credit assessment is available and its respective risk weight is lower than the weight under paragraph 4 shall receive a lower risk weight.

(8) (amended; Darjaven Vestnik, issue 21 of 2009) If the short-term credit assessment assigned to an exposure and its respective risk weight is higher than the weight under paragraph 4, this weight shall be assigned to all exposures to this institution under paragraph 4.

(9) An exposure to an unrated institution may not receive risk weight that is lower than the one associated with an exposure to its corresponding central government.

Short-term Exposures to Institutions in the Corresponding National Currency

Article 34. (1) (amended; Darjaven Vestnik, issue 21 of 2009) Exposures to institutions in the corresponding national currency with a residual maturity of up to 3 months denominated and funded in the same currency shall be assigned a risk weight that is one category less favourable than the respective risk weight for exposures to central governments and central banks as specified in Article 28, paragraphs 3 and 4.

(2) Exposures with a residual maturity of up to 3 months denominated and funded in the national currency of the borrower shall not be assigned a risk weight lower than 20%.

Investments in Other Instruments Recognised as Regulatory Capital

Article 35. Participating interests or investments in other instruments recognised as regulatory capital of other institutions shall be risk weighted at 100%, unless deducted from capital base.

Exposures in the Form of Minimum Reserves

Article 36. For exposures to other institutions in the form of minimum reserves required by the European Central Bank or by the central bank of a Member State, the risk weight of the respective central bank shall apply provided the following conditions have been met:

1. the reserves are held in accordance with Regulation (EC) No. 1745/2003 of the European Central Bank of 12 September 2003 on the application of minimum reserve or a subsequent replacement regulation that includes the national requirements and covers all material aspects of the above Regulation.

2. in the event of bankruptcy or insolvency of the institution where the reserves are held, the reserves are fully repaid to the bank in a timely manner and are not made available to meet other liabilities of the same bank.

Exposures to Corporates

Article 37. (1) Exposures to corporates, for which a credit assessment by a nominated ECAI is available shall be assigned a risk weight according to assigning the credit assessment to one of the six steps in the credit quality assessment scale of Table 5 in the Appendix 3 *Standardised Approach to Credit Risk*.

(2) (amended; Darjaven Vestnik, issue 38 of 2008, effective as of 11 April 2008) Exposures to corporates, for which the banks do not have credit assessment available, shall be assigned the higher of a 100% risk weight or the risk weight of the central government in the jurisdiction of the respective undertaking.

Retail Exposures

Article 38. (amended; Darjaven Vestnik, issue 20 of 2010) Exposures of banks that comply with the criteria listed in Article 26, paragraph 2, shall be assigned a risk weight of 75%.

Exposures Secured by Real Estate Property

Article 39. (amended; Darjaven Vestnik, issue 20 of 2010) (1) Exposures fully secured by real estate property shall be risk weighted at 100% unless otherwise provided for in paragraph 2.

(2) Exposures or any part of an exposure fully and completely secured by first line mortgages on fully secured and evaluated at fair value residential property which is or shall be occupied by or let by the owner for the same purpose, shall be assigned a 35% risk weight provided the following conditions are in place:

1. the value of the property does not materially depend upon the credit quality of the obligor, including where purely macro-economic factors affect both the value of the property and the performance of the borrower; and

2. the risk of the borrower does not materially depend upon the performance of the underlying property, but rather on the underlying capacity of the borrower

to repay the debt from other sources. As such, repayment of the facility does not materially depend on any cash flow generated by the underlying property serving as collateral;

3. the minimum requirements and the valuation rules set out in Article 154 are met; and

4. the value of the exposure or part of it does not exceed 70% of the lower of the fair value or insurance value of the property.

Past-due Items

Article 39a. (1) (new; Darjaven Vestnik, issue 21 of 2009) Past due for items are those exposures, on which the clients have not performed their obligations for more than 90 days.

(2) Exposures under paragraph 1 shall be assigned a risk weight of 100%, unless there are other provisions of this Ordinance, requiring higher risk weight.

(3) An exposure under paragraph 1, for which requirements of Article 39, paragraph 2 are met, may be assigned a risk weight of 50%, if the sum of the recognised impairment losses and specific provisions for credit risk pursuant to Ordinance No. 9 of the BNB for this exposure is no less than 20% of its value before impairment.

Items Belonging to Regulatory High-Risk Categories

Article 40. Exposures associated with particularly high risks such as investments in venture capital firms and private equity investments shall be assigned a risk weight of 150%.

Exposures in the Form of Covered Bonds

Article 41. (1) Exposures in covered bonds shall receive a risk weight one step more favourable than a senior unsecured exposure to the issuing bank in accordance with Table 6 of Appendix 3 *Standardised Approach to Credit Risk*.

(2) Covered bonds shall be secured by any of the following eligible assets:

1. exposures to or guaranteed by central governments, central banks, public sector entities, regional governments and local authorities in the EU Member States;

2. (amended; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) exposures to or guaranteed by non-EU central governments, non-EU central banks, multilateral development banks, international organisations that qualify for the credit quality step 1 and step 2 as set out in Table 1 of Appendix 3 *Standardised Approach to Credit Risk* and exposures to or guaranteed by non-EU public sector entities, non-EU regional governments and non-EU local authorities that are risk weighted as exposures to institutions or central governments according to Article 29, paragraphs 2 and 3; where these exposures qualify for the credit quality step 2, the exposure shall not exceed 20% of the current nominal amount of issued covered bonds of the issuing credit institution;

3. exposures to institutions that qualify for credit quality step 1 as set out in this Chapter. The exposure shall not exceed 15% of the current nominal amount of the issued covered bonds of the issuing credit institution; exposures to EU-institutions that meet the step-2 credit quality requirement as per this Chapter shall be included provided their residual maturity is less than 100 days;

4. loans secured by mortgage on a residential property, to the lower of the amount of the pledge or 80% of the value of the property;

5. (amended; Darjaven Vestnik, issue 102 of 2010, effective as of 1 January 2011) senior shares in a special purpose (securitisation) entities governed by the laws of a Member State, securitising residential real estate exposures provided that at least 90% of the assets of such entities are composed of a mortgage of residential real estate and to the lower of:

a) nominal value of the shares;

b) value of the pledge;

c) 80% of the value of the property pledged.

6. (new; Darjaven Vestnik, issue 102 of 2010, effective as of 1 January 2011) loans secured by a mortgage on a commercial real estate, to the lower of the amount of the pledge and 60% of the value of the property;

7. (new; Darjaven Vestnik, issue 102 of 2010, effective as of 1 January 2011) senior shares in a special purpose (securitisation) entities governed by the laws of a Member State, securitizing commercial real estate exposures provided that at least 90% of the assets of such entities are composed of a mortgage of commercial real estate and to the lower of:

a) nominal value of the shares;

b) value of the pledge;

c) 60% of the value of the property pledged.

(3) (amended; Darjaven Vestnik, issue 102 of 2010, effective as of 1 January 2011) The shares under paragraph 2, item 5 shall have an assigned credit quality step one and not exceed 10% of the nominal amount of the outstanding issue. Exposures caused by transmission and management of payments of the obligors of, or liquidation proceeds in respect of, loans secured by pledged properties of the senior units or debt securities shall not be comprised in calculating the 90% limit from paragraph 2, items 5 and 7. The covered bondholders' claims shall take priority over all other claims on the collateral;

(4) With regard to the real estate collateralising covered bonds, bank – issuer shall meet the minimum requirements specified in Article 154, paragraphs 1 – 4 and the assessment rules defined in Article 154, paragraph 5.

(5) Covered bonds issued before 31 of December 2006 shall be treated under paragraph 1, without applying paragraphs 2 – 4 until their final maturity.

Securitisation Positions

Article 42. Risk weighted exposure amounts of securitisation positions shall be determined in line with Chapter Seven *Securitisation Framework* of this Part.

Short-term Exposures to Institutions and Corporates

Article 43. (amended; Darjaven Vestnik, issue 21 of 2009; amended; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) Exposures to institutions to which Article 33, paragraphs 1 to 6 are applied, and exposures to corporates for which a credit assessment by a nominated ECAI is available shall be assigned a risk weight in accordance with their mapping to the six steps in the credit quality assessment scale in Table 7 of Appendix 3 *Standardised Approach to Credit Risk*.

Exposures to Collective Investment Undertakings (CIUs)

Article 44. (1) Exposures to collective investment undertakings shall receive a risk weight of 100% unless otherwise provided for in Articles 45 – 46.

(2) Exposures to CIUs for which a credit assessment by a nominated ECAI is available shall be risk weighted depending on their correspondence to one of the steps in the credit quality assessment scale in Table 8 of Appendix 3 *Standardised Approach to Credit Risk*.

(3) Exposures to CIUs which in the BNB judgement are associated with high risk shall receive 150% risk weight.

CIUs Recognition Criteria

Article 45. (1) Bank shall determine the risk weights for exposures to CIUs under Article 46, if the following eligibility criteria are met:

1. the CIU is managed by a company, which is subject to supervision in a Member State, or, its activities are approved by the BNB, if the following criteria are met:

a) the CIU is managed by a company, which is subject to supervision similar to that of the EU;

b) the BNB or Financial Supervision Commission has entered into a co-operation agreement with the respective supervisory authority;

2. the CIU's investment prospectus or equivalent document includes:

a) the categories of assets in which the CIU is authorised to invest;

b) the methods for calculating investment limits in case such limits apply;

3. the business of CIU is reported on at least an annual basis to enable an assessment to be made of the activities, assets and liabilities, income and operations over the reporting period.

(2) If a competent authority of a Member State approves a third country CIU, the BNB may consider the requirements under paragraph 1, item 1 are satisfied.

Calculation Procedures for Exposures to CIU

Article 46. (1) Where the bank is aware of the underlying assets in the exposures to a CIU, it shall calculate the average risk weight for the aggregate exposure in accordance with the requirements for underlying exposures in this Chapter.

(2) Where the bank is not aware of the underlying assets in the exposures to a CIU, it shall calculate the average risk weight in accordance with the requirements for underlying exposures as specified in this Chapter by assuming that the CIU first invests, to the maximum extent allowed, in the exposure classes attracting the highest capital requirement, and then continues making investments in descending order in relation with the required capital cover until the maximum total investment limit is reached.

(3) Banks may rely on a third party to calculate a risk weighted underlying exposures in a CIU in accordance with paragraph 1, provided that the correctness of the calculation could be adequately ensured by the bank.

Other Items

Article 47. (1) Exposures in fixed assets shall attract a risk weight of 100%.

(2) Prepayments and accrued receivables for which the bank is unable to determine the relevant counterparty shall be risk weighted at 100%.

(3) Cash in hand and equivalent cash items shall be assigned a 0% risk weight.

(4 Cash items in the process of collection shall be assigned a 20% risk weight.

(5) Holdings of equity and other participations, except where deducted from own funds, shall be assigned a risk weight of at least 100%, unless otherwise specified in Article 40.

(6) Gold bullion held in own vaults or on an allocated basis, recognised on the gold markets, shall be assigned a 0% risk weight.

(7) In the case of asset sale and repurchase agreements and outright forward purchases, the risk weight shall be that assigned to the underlying assets.

Treatment of n^{th} to Default Derivatives

Article 48. (1) Where a bank provides simultaneously protection with credit derivative for a number of exposures under terms that the n^{th} default among the exposures shall trigger payment by the bank and that this credit event shall terminate the contract, the risk weights of the exposures shall be calculated as follows:

1. where the product has an external credit assessment from an eligible ECAI, the risk weights to be assigned shall be subject to the correspondence of the credit assessment to one of the credit quality steps in the assessment scale prescribed in Table 1 of Appendix 6 *Securitisation*.

2. if the product is not rated by an eligible ECAI, the risk weights of the exposures included in the basket will be aggregated, excluding *n-1* exposures, up to a maximum of 833% of the notional value of credit derivative; the *n-1* exposures to

be excluded from the aggregation shall be determined on the basis of excluding the exposures that produce lower risk weights than any of the exposures included in the aggregation; the sum total of the risk weights of the exposures remaining in the basket shall be multiplied by the nominal amount of the protection provided by the credit derivative.

Exposures to Leases

Article 48a. (new; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) (1) The exposure value for leases shall be the discounted minimum lease payments. Any guaranteed residual value fulfilling the set of conditions in Article 143 regarding the eligibility of protection providers, as well as the minimum requirements for recognising other types of guarantees provided for in Articles 146 to 148, shall also be included in the minimum lease payments.

(2) The exposure under paragraph 1 shall be assigned to the relevant exposure class in accordance with Article 26.

(3) When the exposure is a residual value of a leased asset in accordance to a lease contract, the risk weighted exposure amount shall be calculated by dividing the result under paragraph 1 by the residual term of the lease contract specified in years with the result rounded to the nearest figure not less than 1.

Section Four

REQUIRMENTS FOR RECOGNITION OF EXTERNAL CREDIT ASSESSMENT INSTITUTIONS (ECAIS) AND EXPORT CREDIT AGENCIES (ECA)

General Provisions

Article 49. (1) To establish the risk weights of their exposures banks may use credit assessments assigned by ECAIs or ECA included in the list under Article 27, paragraph 2.

(2) (amended; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) Where an ECAI is registered as a credit rating agency in accordance with Regulation (EC) No 1060/2009 of 16 September 2009 of the European Parliament and of the Council on credit rating agencies, the methodology for assigning credit assessments by an ECAI and the credit assessment assigned shall meet the criteria in Article 50.

(3) An ECA shall be recognised as eligible for inclusions in the list under Article 27, paragraph 2, if either of the following conditions are in place:

1. it applies the OECD agreed methodology for assigning credit assessments;

2. its assessments are associated with one of the eight minimum export insurance premiums established by that methodology;

3. it publishes periodically its assessments.

(4) The list under Article 27, paragraph 2 may include consensus risk scores from Export Credit Agencies participating in the OECD arrangement for the principles of officially supported export credits;

(5) BNB publishes and updates the list with recognised agencies and the mapping of their credit assessments.

Requirements for Recognising an ECAI's Methodology for Assigning Credit Assessments

Article 50. (1) For recognising the credit assessments of a certain ECAI, its methodology for assigning these credit assessments must meet the minimum requirements for objectivity, independence, ongoing review, transparency and disclosure.

(2) The objectivity requirement shall be met when the methodology is rigorous, systematic, continuous and subject to validation based on historical experience.

(3) The independence requirement shall be met when the methodology is free from external political influences or constraints, and from economic pressures that may influence the credit assessment. Independence of the ECAI's methodology shall be assessed by the BNB taking account of at least the following factors:

1. owners and organisation structure of the ECAI;
2. financial resources of the ECAI;
3. staffing and expertise of the ECAI;
4. corporate governance of the ECAI.

(4) The ongoing review requirement shall be met when:

1. the agency's credit assessments are subject to ongoing review and shall be responsive to changes in the financial conditions. Such review shall take place after all significant events and at least annually;

2. the assessment methodology for each market segment is established according to the following minimum standards:

a) the back-testing must be established for at least one year;

b) the regularity of the review process by the ECAI must be monitored by the BNB;

c) the ECAI has made the commitment to submit to the BNB information on its contacts with the entities which it rates that may influence the objectivity of the assessments.

3. The ECAI has made the commitment to promptly inform the BNB about any material changes in the methodology they use for assigning credit assessments.

(5) The requirement for transparency and disclosure shall be met when the principles of the methodology employed by the ECAI for the formulation of its credit assessments are transparent and publicly available as to allow all potential users to decide whether they are derived in a reasonable way.

Individual Credit Assessments

Article 51. (1) For recognising an ECAI, its credit assessments must be recognised in the market as credible and reliable by the users of such credit assessments.

(2) Credibility of credit assessments shall be assessed by the BNB according to the following criteria:

1. market share of the ECAI;
2. financial resources of the ECAI and the revenues generated by the ECAI from the assigned credit assessments;
3. whether there is any pricing of financial instruments on the basis of the rating;
4. at least two banks use the ECAI's individual credit assessments for bond issuing and/or assessing credit risks.

(3) Individual credit assessments must be accessible at equivalent terms at least to all credit institutions and other entities having a legitimate interest in these individual credit assessments, whether these are domestic or non-domestic parties.

Mapping Assessments

Article 52. (1) The BNB shall differentiate between the relative degrees of risk expressed by each credit assessment by considering the long-term PD value associated with all exposures assigned the same credit assessment. Recently established ECAIs and those that have compiled only a short record of default data shall submit to the BNB their estimated long-term default rates associated with all exposures assigned the same credit assessment.

(2) In addition to paragraph 1, the BNB shall differentiate between the relative degrees of risk expressed by each credit assessment by considering at least the following qualitative factors:

1. the pool of issuers that the ECAI covers;
2. the range of credit assessments that the ECAI assigns;
3. the detailed description of each credit assessment meaning;
4. the ECAI's definition of default.

(3) The BNB shall compare default rates experienced for each credit assessment of a particular ECAI and compare them with a benchmark built on the basis of default rates experienced by other ECAIs on a population of issuers that the BNB believes to present an equivalent level of credit risk.

(4) When the BNB believe that the default rates experienced for the credit assessment of a particular ECAI are materially and systematically higher then the benchmark, the BNB shall assign a higher credit quality step in the credit quality assessment scale to the ECAI credit assessment.

(5) When the BNB has increased the associated risk weight for a specific credit assessment of a particular ECAI, if the ECAI demonstrates that the default rates experienced for its credit assessment are no longer materially and systematically higher than the benchmark, the BNB may decide to restore the original credit quality step in the credit quality assessment scale for the ECAI credit assessment.

(6) The BNB may recognise the risk weights and steps assigned by the competent authorities of another EU Member State, which have been determined in a manner similar to that set out in Articles 50 – 52, without the BNB doing its own determination.

Section Five
ADDITIONAL CRITERIA FOR USE OF ECAIS CREDIT ASSESSMENTS

Credit Assessments from more than one ECAI

Article 53. (1) Banks may nominate one or more eligible ECAIs to determine the risk weights of their assets and off-balance sheet items.

(2) Banks may use only solicited credit assessments. Unsolicited credit assessment for the purposes of risk weighting of exposures shall not be applied.

(3) Banks shall apply the assessments of an ECAI consistently throughout the period of their application.

(4) Banks can only use credit assessments that take into account all amounts both in principal and in interest owed to them.

(5) If credit assessments are available from two nominated ECAIs and they correspond to different risk weights for a rated item, the higher risk weight shall be assigned.

(6) If credit assessments are available from three or more nominated ECAIs for a rated item and these assessments correspond to different risk weights, the two assessments generating the two lowest risk weights shall be referred to for the purposes of risk weighting, after which the requirement from the foregoing paragraph shall be applied.

Issuer and Issue Credit Assessment

Article 54. (1) Where a credit assessment exists for a specific issuing program or facility to which the exposure belongs, this credit assessment shall be used to determine the risk weight to be assigned to that exposure.

(2) Where no credit assessment exists for a certain exposure of the bank, but an individual credit assessment exists for the borrower or for a specific issuing program or facility to which the exposure does not belong, then that credit assessment shall be used if it produces a higher risk weight than would otherwise be the case of the unrated exposure.

(3) The credit assessment under paragraph 2 may be used when the bank's unrated exposure ranks pari passu or senior in all respects to the specific rated issuing program or facility or to senior unsecured exposures of that issuer, as relevant.

(4) Paragraphs 1 – 3 are not to prevent the application of Article 41.

(5) Credit assessments for issuers within a corporate group cannot be used as credit assessment of another issuer within the same corporate group.

Use of Long-term and Short-term Credit Assessments

Article 55. (1) Short-term credit assessments may only be used for short-term exposures and off-balance sheet exposures to institutions and corporates.

(2) Except in the cases under paragraphs 3 and 4, short-term credit assessments shall not be used to derive risk weights for exposures other than the exposure that has been rated.

(3) If a short-term rated facility is assigned a 150% risk weight, then all unrated unsecured exposures on that obligor whether short-term or long-term shall also be assigned a 150% risk weight for the unsecured part.

(4) If a short-term rated facility is assigned a 50% risk weight, no unrated short-term or long-term exposures on that obligor shall be assigned a risk weight lower than 100%.

Domestic and Foreign Currency Exposures

Article 56. A credit assessment that refers to an item denominated in the obligor's domestic currency shall not be used to derive a risk weight for another exposure on that same obligor that is denominated in a foreign currency.

Chapter Five

CALCULATING CAPITAL REQUIREMENTS FOR CREDIT RISK BY USING INTERNAL MODELS

Section One

GENERAL PROVISIONS

Approval Issuance

Article 57. (1) To calculate their risk weighted exposure amounts banks may use an Internal Ratings Based Approach (IRB Approach) following approval of the Deputy Governor heading the Banking Supervision Department based on a written application accompanied by the relevant documents.

(2) Permission under paragraph 1 shall be given in 1 year period after the submission of the request and only if the bank proves that the system for the management and rating of credit risk exposures is sound and implemented with integrity and that it meets the following requirements:

1. the bank's rating system provides a meaningful assessment of obligor and transaction characteristics, an accurate and consistent quantitative estimates and meaningful differentiation of risk;

2. internal ratings and default and loss estimates used in the calculation of capital requirements and associated systems and processes play an essential role in the risk management and decision-making process, and in the credit approval, internal capital allocation and governance functions of the bank;

3. the bank has a credit risk control unit responsible for its rating systems that is appropriately independent;

4. the bank collects and stores all relevant data to provide effective support to its credit risk measurement and management process;

5. the bank documents all aspects of its rating system and periodically validates it;

6. all requirements set out in Section Five *Minimum Requirements for Internal Rating Based Approach* of this Chapter are met;

(3) Where a bank or financial holding domiciled in a Member State and their subsidiaries use the IRB Approach on a unified basis, the BNB may allow the requirements under Article 58, paragraph 2 to be met at a group level.

(4) (amended, Darjaven Vestnik, issue 21 of 2009) In order for a bank to qualify to use the IRB Approach for a certain class of exposures for risk measurement and management purposes, it shall demonstrate that it has been using that approach for at least three years in a row prior to qualification, and that during the last year the bank's capital requirements for credit risk have been reported to the BNB in parallel with the standardised approach.

(5) (amended, Darjaven Vestnik, issue 21 of 2009) A bank applying for the use of own estimates of Loss Given Default (LGDs) and/or conversion factors shall have a permission from BNB, which is issued within a period of one year after the submission of the request and shall demonstrate that it has been estimating these parameters for at least three years in a row prior to qualification in consistence with the requirements set out in Section Five *Minimum Requirements for Internal Rating Based Approach* of this Chapter. During the third year bank's capital requirements for credit risk shall be reported to the BNB in parallel with the standardised approach or the IRB approach without using own estimates.

(6) Where a bank which has received a permission to use the IRB Approach is in compliance with the requirements set forth in this Section, the BNB shall require from the bank to present a plan for a timely return to compliance, unless that bank is able to demonstrate that the effect of non-compliance is immaterial.

Sequentially Implementation

Article 58. (1) Banks, parent undertakings and their subsidiaries which are subject of consolidated supervision by BNB as set out in Law on Credit Institutions, shall implement the IRB Approach for all exposures, unless the conditions of Article 62 are in place.

(2) Subject to the permission of the BNB based on an approved plan, the IRB Approach implementation may be carried out sequentially for a period maximum of two years across the different exposure classes, referred to in Article 59, within the same business unit or across different business units in the same group.

(3) The above applies also for the use of own estimates of LGDs or conversion factors for the calculation of risk weights for exposures to central governments and central banks, institutions and corporates.

(4) In the case of the retail exposure class referred to in Article 59, paragraph 1, item 4, implementation may be carried out sequentially across the categories of exposures to which the different correlations in Article 64, paragraphs 2, 4 and 5 correspond.

(5) A bank using the IRB Approach for any exposure class shall at the same time use the IRB Approach for the equity exposure class.

(6) A bank which has obtained permission under Article 57, paragraph 1 to use the IRB Approach shall not revert to the use of the Standardised Approach except for demonstrated good cause and subject to the approval of the BNB.

(7) A bank which has obtained permission under Article 57, paragraph 5 to use own estimates of LGDs and conversion factors shall not revert to the use of LGD values and conversion factors referred to in Article 60, paragraph 8 except for demonstrated good cause and subject to the approval of the BNB.

Exposure Classes

Article 59. (1) Banks shall assign each exposure to one of the following exposure classes:

1. claims or contingent claims on central governments and central banks;
2. claims or contingent claims on institutions;
3. claims or contingent claims on corporates;
4. retail claims or contingent retail claims;
5. equity claims;
6. securitisation positions;
7. other non-credit obligation assets.

(2). The following exposures shall be treated as exposures for claims or contingent claims on central governments and central banks under Article 59, paragraph 1, item 1:

1. exposures to regional governments or local authorities treated as exposures to the central government within the meaning of Chapter Four *Standardised Approach* of this Part;
2. exposures to Multilateral Development Banks and International Organisations in accordance with List 1 and 2 of Appendix 3 *Standardised Approach for Credit Risk,* which attract a risk weight of 0% under Chapter Four *Standardised Approach* of this Part.

(3) The following exposures shall be treated as exposures for claims or contingent claims on institutions under Article 59, paragraph 1, item 2:

1. exposures to regional governments and local authorities which are not treated as exposures to central governments under Chapter Four *Standardised Approach* of this Part;

2. exposures to public sector entities, which are treated as exposures to institutions under Chapter Four *Standardised Approach* of this Part;

3. exposures to Multilateral Development Banks, which do not attract a 0% risk, weight as per Chapter Four *Standardised Approach* of this Part.

(4) To be eligible for the retail exposure class referred to in Article 59, paragraph 1, item 4, of paragraph 1, an exposure shall meet the following criteria:

1. it shall be either to a natural person or persons, or to a small or medium sized entity;

2. the total amount owed to the bank and parent undertakings and its subsidiaries, including any past due exposure, by the obligor client or group of connected clients, but excluding claims or contingent claims secured on residential real estate collateral under Article 39, paragraph 2, shall not exceed BGN 500 000;

3. the exposure shall be treated by the bank in its risk management consistently over time and in a manner similar to all other exposures of a similar kind;

4. the exposure is not managed just as individually and is part of a portfolio of similarly managed exposures of comparable characteristics;

(5) The following exposures shall be classed as equity exposures under paragraph 1, item 5:

1. non-debt exposures conveying a subordinated, residual claim on the assets or income of the issuer;

2. debt instruments the economic substance of which is similar to the exposures specified in item 1.

(6) Within the corporates exposure class under paragraph 1, item 3 the bank shall separately identify as specialised lending exposures, exposures that possess the following characteristics:

1. the exposure is to an entity, which was created specifically to finance and/or operate physical assets;

2. the contractual arrangements give the bank a substantial degree of control over the assets and the income that they generate;

3. the primary source of repayment of the obligation is the income generated by the assets being financed;

(7) Any credit obligation not assigned to the exposure classes referred to in paragraph 1, items 1, 2, 4, 5 and 6 shall be assigned to the exposure class referred to in paragraph 1, item 3.

(8) The exposure class referred to in paragraph 1, item 7 shall include the residual value of leased properties under agreements that are not treated as loans.

(9) The methodology used by the bank for assigning exposures to different exposure classes under paragraph 1 shall be appropriate and consistent over time.

Risk Weighted Exposure Amount

Article 60. (1) The risk weighted exposure amounts for credit risk for exposures belonging to one of the exposure classes referred to in Article 59, paragraph 1, items 1 – 5 and item 7 shall, unless deducted from own funds, be calculated in accordance with Articles 63 – 69.

(2) The risk weighted exposure amounts for dilution risk for purchased receivables shall be calculated according to Article 70. In order to determine the amount of the default risk and the dilution risk, in the case where a bank has full recourse to the seller of the purchased receivables, the exposures shall be treated as collateralised.

(3) The calculation of risk weighted exposure amounts shall be based on risk parameters: probability of default (PD), loss given default (LGD), exposure at default (EAD), and effective maturity (M). The PD and LGD indicators may be considered separately or jointly, in accordance with Section Three *Calculation of PD, LGD and M* of this Chapter.

(4) The BNB shall issue a permission to a bank to calculate its risk weighted exposures in equity instruments by using one of the approaches given in Articles 65 – 68. To qualify for internal models as per Article 68 the bank shall meet the minimum requirements under Articles 121 -123.

(5) (amended; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) The calculation of risk weighted exposure amounts for credit risk for specialised lending exposures shall comply with Article 63, paragraph 7, and if it is the case, an explicit approval by the BNB of the risk-weights assignment methodology is required.

(6) For risk weighting of exposures referred to in Article 59, paragraph 1, items 1 to 4, banks shall provide their own estimates of PD in accordance with Article 57.

(7) For risk weighting of exposures belonging to the exposure class referred to in Article 59, paragraph 1, item 4 the bank shall provide own estimates of LGDs and conversion factors in accordance with Article 57.

(8) (amended; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) For risk-weighting of exposures belonging to the exposure class referred to in Article 59, paragraph 1, items 1 – 3 the bank shall apply the LGD values as specified in Article 75, paragraph 1 and conversion factors in accordance with Article 84, paragraph 1, item 1 – 3.

(9) (amended; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) Upon permission of the BNB under Article 57, paragraph 5 the bank may use own estimates of the LGD indicator and conversion factors for exposures belonging to the exposure classes referred to in Article 59, paragraph 1, items 1 to 3 in accordance with the requirements of Article 57.

(10) For risk-weighting of exposures under 59, paragraph 1, item 6 and securitisation exposures Chapter Seven *Securitisation Framework* shall apply.

(11) Where exposures in the form of a collective investment undertaking (CIU) meet the criteria set out in Article 45 and the bank is aware of all of the underlying

exposures, the bank shall calculate the risk weighted exposure amounts and expected loss amounts by applying the IRB Approach to the underlying exposures. Where the bank does not apply the IRB Approach to an underlying exposure, it shall calculate the risk weighted exposure amounts and expected loss amounts as follows:

1. (amended; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) for exposures belonging to the equity exposure class, the approach set out in Article 66 shall apply; if the bank is unable to differentiate between private equity, exchange-traded and other equity exposures, it shall treat the exposures concerned as other equity exposures; where exposures to equities in the form of an indirect holding through CIU, taken together with the credit institution's direct exposures in that exposure class, are not material within the meaning of Article 62, paragraph 2, paragraph 1 of this Article may be applied;

2. (amended; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) for all other underlying exposures, the approach set out in Chapter Four *Standardised Approach* of this Part shall apply in keeping with the following requirements:

a) for unrated exposures or exposures subject to the credit quality step yielding the highest risk weight for a given exposure class, the risk weight must be multiplied by a factor of two but must not be higher than 833%;

b) for all other exposures, the risk weight must be multiplied by a factor of 1.1 and must be higher than 5%.

(12) (amended; Darjaven Vestnik, issue 38 of 2008, effective as of 11 April 2008; amended; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) Where exposures in the form of a CIU do not meet the criteria set out in Article 45, or the bank is not aware of all of the underlying exposures of the CIU, the bank shall look through to the underlying exposures and calculate risk weighted exposure amounts and expected loss amounts in accordance with Article 66. This treatment shall apply also to those underlying exposures the credit institution is not aware of or could not reasonably be aware of, as well as where it would be unduly burdensome for the credit institution to look through the underlying exposures in order to calculate risk-weighted exposure amounts and expected loss amounts in accordance with methods set out in this Chapter.

(13) (amended; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) The bank may rely on a third party to calculate and report the average risk weighted exposure amounts based on the CIU's underlying exposures in accordance with paragraph 11, provided that the correctness of the calculation is adequately ensured.

Expected Loss

Article 61. (1) The expected loss amounts for exposures belonging to one of the exposure classes referred to in Article 59, paragraph 1, items 1 to 5 shall be calculated in accordance with Article 71.

(2) The calculation of expected loss amounts in accordance with paragraph 1 shall be based on the same input figures of PD, LGD and the exposure value (EAD), which are used for the calculation of the risk weighted amounts of exposures as per Article 60. For defaulted exposures, where banks use own estimates of LGDs, EL shall be the bank's best estimate in accordance with Article 110, paragraph 8.

(3) The expected loss amounts for securitised exposures shall be calculated in accordance with Chapter Seven *Securitisation Framework*.

(4) The expected loss amount for exposures belonging to the exposure class referred to in Article 59, paragraph 1, item 7 shall be zero.

(5) The expected loss amounts for dilution risk of purchased receivables shall be calculated in accordance with Article 71, paragraph 9.

(6) The expected loss amounts for exposures referred to in Article 60, paragraphs 11 to 13 shall be calculated in accordance with Article 71.

Partial Application of Standardised Approach

Article 62. (1) Upon permission of the BNB a bank which has been given permission to use the IRB Approach in the calculation of risk weighted exposure amounts and expected loss amounts for one or more exposure classes may apply the standardised approach for the following:

1. the exposure class referred to in Article 59, paragraph 1, item 1 or item 2, where the number of material counterparties is limited and it would be unduly burdensome for the bank to implement a rating system for these counterparties;

2. exposures in non-significant business units as well as exposure classes that are immaterial in terms of size and perceived risk profile;

3. (amended; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) exposures to central governments of a Member State and their regional governments, local authorities and administrative bodies, provided that:

a) there is no difference in risk between the exposures to the central government and exposures to the relevant authorities because of specific public arrangements;

b) exposures to the central government correspond to credit quality step 1 as per Chapter Four *Standardised Approach* of this Part;

4. exposures to a counterparty which is its parent undertaking, its subsidiary or a subsidiary of its parent undertaking provided that the counterparty is an institution or a financial holding company, financial institution, asset management company or ancillary services undertaking linked to any of the above, which are subject to appropriate prudential requirements;

5. equity exposures to entities whose credit obligations qualify for a 0% risk weight under Chapter Four *Standardised Approach* of this Part, including those public entities where a zero risk weight is applied;

6. equity exposures incurred under legislative programmes to promote specified sectors of the economy that provide significant subsidies for the investment to the bank and involve some form of government oversight and restrictions on these pro-

grammes; exclusion of these exposures from the IRB Approach is possible where their nominal amount is below 10% of the own funds;

7. the exposures identified in Article 36;

8. exposures related to State guarantees in accordance with Article 148.

(2) For the purposes of paragraph 1, item 2 the equity exposure class shall be considered material if their annual average value, excluding the exposures under paragraph 1, item 6 exceeds 10% of the institution's capital base. Where the number of individual equity exposures is less than 10, the threshold from the foregoing sentence shall be 5%.

Section Two

CALCULATION OF RISK WEIGHTED EXPOSURE AMOUNTS AND EXPECTED LOSS AMOUNTS

(title amended; Darjaven Vestnik, issue 38 of 2008, effective as of 11 April 2008)

Risk Weighted Amount of Exposures to Central Governments and Central Banks, Institutions and Corporates

Article 63. (1) The risk weighted exposure amounts for credit risk under the IRB Approach shall be calculated by applying the parameters PD, LGD, effective maturity value (M) and exposure value (EAD) as set out Section Three *Calculation of PD, LGD and M* and Section Four *Exposure Value* of this Chapter using the Formulae of Appendix 4 *IRB Approach*.

(2) The risk weighted amount of exposures to central governments or central banks, institutions and corporates shall be calculated in accordance with Formulae 1–4 in Appendix *IRB Approach.*

(3) (amended; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) Defaulted exposures where banks apply the LGD values set out in Article 75, paragraphs 1 – 2, shall attract 0% risk weight;

(4) For defaulted exposures where banks use own estimates of LGDs, the risk weight shall be calculated with Formula 5 of Appendix 4 *IRB Approach*.

(5) Risk weighted amount of exposures, which meet the criteria under Articles 151 and 156, can be adjusted following Formula 6 of Appendix 4 *IRB Approach*.

(6) (amended; Darjaven Vestnik, issue 38 of 2008, effective as of 11 April 2008) For exposures to corporates where the sales on a consolidated basis are less than EUR 50 million, the bank may take as a value of the correlation factor calculations with Formula 7 of Appendix 4 *IRB Approach*. The bank shall use total consolidated assets instead of total consolidated sales where the former provides a better estimate of the size of the group activity.

(7) For specialised lending exposures in respect of which a bank can not demonstrate that its PD estimates meet the minimum requirements as set out in Section

Five *Minimum Requirements for Internal Rating Based Approach* of this Chapter, it shall assign the risk weights according to Table 1 of Appendix 4 *IRB Approach*. In determining the risk weights the bank shall take into account the following factors:

1. financial status of the obligor;
2. political and legal environment;
3. transaction and/or asset characteristics;
4. strength of the sponsor/developer, including any public private partnership income stream;
5. security package.

(8) Purchased corporate receivables shall comply with the minimum requirements set out in Articles 118 and 119. For these exposures, the quantification standards for exposures under Article 59, paragraph 1, item 4 may be used provided that exposures to purchased corporate receivables met the requirements set out in Article 64, paragraph 6, and where it would be unduly burdensome for the bank to treat such exposures as corporate exposures as set out in Section Five *Minimum Requirements for Internal Rating Based Approach* of this Chapter.

(9) The following exposures may be treated as first-loss positions under Chapter Seven *Securitisation Framework*:

1. exposures on purchased receivables and the relevant refundable purchase discounts;
2. collateral or partial guarantees for the exposures under item 1 that provide first-loss protection for default losses or dilution losses.

(10) Where a bank provides credit derivative protection for a number of exposures under terms that the n^{th} default among the exposures shall trigger a payment by the bank and that this credit event shall terminate the contract, the risk weights of these exposures shall be calculated as follows:

1. if the product has an external credit assessment from an eligible ECAI, the risk weights will be applied by mapping the credit assessment onto one of the credit quality steps in the assessment scale set out in Table 1 of Appendix 6 *Securitisation*;
2. if the product is not rated by an eligible ECAI, the risk weights of the exposures included in the basket will be aggregated, excluding *n-1* exposures where the sum of the risk weights of the other exposures shall not exceed 833% of the notional amount of the protection provided by the credit derivative; the *n-1* exposures to be excluded from the aggregation shall be determined on the basis that they shall include those exposures each of which produces a lower risk-weighted exposure amount than the risk-weighted exposure amount of any of the exposures included in the aggregation; the obtained sum of risk weights of the other exposures in the aggregation shall be multiplied by the notional amount of the protection provided by the credit derivative.

Risk Weighted Exposure Amounts for Retail Exposures

Article 64. (1) The risk weighted exposure amounts for retail exposures shall be calculated according to the Formulae 7, 8, 9 and 10 of Appendix 4 *IRB Approach*.

(2) The risk weights for defaulted exposures shall be calculated based on Formula 11 of Appendix 4 *IRB Approach* with the probability of default (PD) being 1.

(3) The risk weighted exposure amount for each exposure to small and medium sized entities, treated as retail exposures, shall be calculated according to Article 63, paragraph 5, where these exposures met the requirements set out in Articles 156 and 151.

(4) For retail exposures fully secured by real estate collateral a correlation (R) of 0.15 shall apply.

(5) For qualifying revolving retail exposures a correlation (R) of 0.04 shall apply. In order to qualify as such, exposures shall meet the following requirements:

1. the exposures are to individuals;

2. the exposures are revolving, unsecured, and unconditionally cancellable by the bank up the amount of the undrawn portion; undrawn commitments on loans may be considered unconditionally cancellable to the extent allowable;

3. the maximum revolving exposure to a single individual is BGN 50 000 or less;

4. the bank can demonstrate that the use of the correlation is limited to portfolios that have exhibited low volatility of loss rates, especially within the low PD bands;

5. the BNB agrees that treatment as a qualifying revolving retail exposure is consistent with the underlying risk characteristics of the sub-portfolio of exposures in question.

(6) To be eligible for the retail treatment, purchased receivables shall comply with both the requirements set out in Articles 118 and 119 and the following conditions:

1. the receivables are purchased from unrelated, third party sellers, and do not include any exposures that are directly or indirectly originated by the bank;

2. the seller's claim on the obligor shall be generated on an arm's-length basis as unrelated parties; receivables subject to contra-accounts between firms that buy and sell to each other are ineligible;

3. the purchasing bank has a claim on all proceeds from the purchased receivables or a pro-rata interest in the proceeds;

4. the portfolio of purchased receivables is sufficiently diversified.

(7) The following exposures may be treated as first-loss positions under Chapter Seven *Securitisation Framework*:

1. exposures on purchased receivables and the relevant refundable purchase discounts;

2. collateral or partial guarantees for the exposures under item 1 that provide first-loss protection for default losses or dilution losses.

(8) For hybrid pools of purchased retail receivables where the bank cannot separate exposures secured by real estate collateral and qualifying revolving retail exposures from other retail exposures, the risk weight function producing the highest capital requirements calculated by Formula 9 of Appendix 4 *IRB Approach* shall apply.

Risk Weighted Exposure Amounts for Equity Exposures

Article 65. (1) To calculate the risk weighted exposure amounts for its equity exposures banks may use one of the following three approaches: Simple risk-weight approach, PD/LGD Approach and Internal Models Based Approach.

(2) Banks may employ different approaches to different portfolios following written BNB approval and provided that these approaches are used for internal purposes, consistently and not for the sake of achieving lower capital requirements.

(3) Equity exposures to ancillary service undertakings shall be treated according to the treatment of other non-credit obligation assets.

Simple Approach

Article 66. (1) The risk weighted exposure amount according to the simple risk weight approach shall be calculated by multiplying the exposure by the risk weights as follows:

1. 190% for private equity exposures in sufficiently diversified portfolios;
2. 290% for exchange traded equity exposures;
3. 370% for all other equity exposures.

(2) Short cash positions and derivative instruments held in the banking book are permitted to offset long positions in the same individual stocks provided that these instruments have been explicitly designated as hedges for at least another year. All other short positions are to be treated as if they are long positions with the relevant risk weight assigned to the absolute value of each position.

(3) For maturity mismatched positions, the method shall be that applied for corporate exposures.

(4) (amended; Darjaven Vestnik, issue 38 of 2008, effective as of 11 April 2008) In calculating the risk weighted equity exposures the bank may recognise unfunded credit protection in accordance with the methods set out in Chapter Six *Credit Risk Mitigation*.

PD/LGD Approach

Article 67. (1) (amended; Darjaven Vestnik, issue 38 of 2008, effective as of 11 April 2008) The risk weighted exposure amounts according to PD/LGD Approach shall be calculated with Formulae 1, 2, 3 and 4 in Appendix 4 *IRB Approach*. Where the bank does not have sufficient information to determine default as per the definition in Articles 101 – 102, the risk weight of equity exposures shall be multiplied by factor 1.5.

(2) For each individual exposure the sum of the expected loss amount multiplied by 12.5 plus the risk weighted exposure amount shall not exceed the exposure value multiplied by 12.5.

(3) (amended; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) In calculating the risk weighted equity exposures the bank may recognise unfunded credit protection in accordance with the methods set out in Chapter Six

Credit Risk Mitigation. The exposure to the provider of the protection shall be subject to an LGD of 90%. For exposures under Article 66, paragraph 1, item 1, an LGD of 65% shall apply for the purpose of which M shall be 5 years.

Internal Models Approach

Article 68. (1) The risk weighted exposure amount in accordance with the Internal Models Approach shall be the potential loss as derived using that model, multiplied by 12.5. In determining the potential loss amount, a 99th percentile, one-tailed confidence interval of the difference between quarterly returns and an appropriate risk-free rate computed over a long-term sample period shall be applied.

(2) (amended; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) The risk weighted exposure amounts at the individual exposure level shall not be less than the sum of minimum risk weighted exposure amount required under the approach given in Article 63 and the corresponding expected loss amount multiplied by 12.5. The expected loss amount of the foregoing sentence shall be calculated on the basis of the PD values set out in Article 80, paragraph 2 and the LGD values set out in Article 81, paragraphs 1 and 2.

(3) The bank may recognise unfunded credit protection with guarantees on its equity exposures.

Risk Weighted Exposure Amounts for Non-credit Obligation Assets

Article 69. (1) The risk weighted exposure amounts for non credit-obligation assets shall be calculated by applying a risk weight of 100% to the exposure value.

(2) (amended; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) For exposures, which are residual values of minimum lease payments, the risk weighted amounts shall be calculated by dividing the result in paragraph 1 by the residual term of the lease agreement specified in years and the result is rounded to the nearest figure but not less than 1.

Calculation of Risk Weighted Exposure Amounts for Dilution Risk of Purchased Receivables

Article 70. (1) Risk weights for dilution risk of purchased corporate and retail receivables shall be calculated according to Formulae 1 – 3 in Appendix 4 *IRB Approach* in compliance with the following requirements:

1. the input parameters PD and LGD shall be determined as set out in Section Three *Calculation of PD, LGD and M* of this Chapter;

2. the exposure value shall be determined as set out in Section Four *Exposure Value* of this Chapter;

3. the effective maturity M shall be 1 year.

(2) If the bank can demonstrate that dilution risk is immaterial, no capital requirements for this risk type need be calculated.

Calculation of Expected Loss Amounts

Article 71. (1) Unless specified otherwise herein, the values of the PD and LGD parameters shall be determined as set out in Section Three *Calculation of PD, LGD and M* of this Chapter and the exposure value shall be determined as per Section Four *Exposure Value* of this Chapter.

(2) The expected loss amounts for exposures to central governments, central banks, institutions, corporates and retail exposures shall be calculated according to Formula 14 of Appendix 4 *IRB Approach*.

(3) Expected loss amount for defaulted exposures, provided the bank uses its own LGD estimates, shall be equal to the best estimate, calculated in accordance with Article 110, paragraph 8.

(4) Expected loss for exposures subject to the treatment set out in Article 63, paragraph 5, shall be zero.

(5) Expected loss values for specialised lending exposures where the bank uses the methods set out in Article 63, paragraph 7 for assigning risk weights shall be assigned according to Table 2 of Appendix 4 *IRB Approach*.

(6) The expected loss amounts for equity exposures where the risk weighted exposure amounts are calculated according to the Simple Approach set out in Article 66, shall be determined as follows:

1. 0.8% for private equity exposures in sufficiently diversified portfolios;
2. 0.8% for exchange traded equity exposures;
3. 2.4% for all other equity exposures.

(7) The expected loss amounts for equity exposures where the risk weighted exposure amounts are calculated according to the methods set out in Article 67, paragraphs 1 – 3 shall be calculated according to Formula 14 of Appendix 4 *IRB Approach*.

(8) The expected loss amounts for equity exposures where the risk weighted exposure amounts are calculated according to the methods set out in Article 68, paragraphs 1 – 3 shall be 0%.

(9) The expected loss amounts for dilution risk shall be calculated according to the Formula 14 of Appendix 4.

Treatment of Expected Loss Amounts

Article 72. (amended; Darjaven Vestnik, issue 38 of 2008; amended; Darjaven Vestnik, issue 102 of 2010, effective as of 1 January 2011) The expected loss amounts calculated in accordance with Article 71, paragraphs 1 – 5 and paragraph 9 shall be subtracted from the sum of value adjustments and provisions related to these exposures. Discounts on exposures purchased when in default according to Article 82, paragraph 1 shall be treated as a revaluation reserve. Expected loss amounts for securitised exposures, provisions and other value adjustments related to these exposures shall not be included in this calculation.

Section Three

CALCULATION OF PROBABILITY OF DEFAULT (PD), LOSS GIVEN DEFAULT (LGD) AND MATURITY VALUE (M)

General Provisions

Article 73. The input parameters PD, LGD and M into the calculation of risk weighted exposure amounts and expected loss amounts specified in Section Two *Calculation of Risk Weighted Exposure Amounts and Expected Loss Amounts* of this Chapter, shall be those estimated by the bank in accordance with Section Five *Minimum Requirements for Internal Rating Based Approach* of this Chapter.

Probability of Default (PD) for Exposure to Central Governments, Central Banks, Corporates and Institutions

Article 74. (1) The PD of exposures to corporates or institutions shall be at least 0.03%;

(2) For purchased corporate receivables in respect of which the bank cannot demonstrate that its PD estimates meet the minimum requirements set out in Section Five *Minimum Requirements for Internal Rating Based Approach*, the PD parameter shall be determined according to the following principles:

1. for senior claims on corporates PD shall be the EL estimate divided by LGD for these receivables;
2. for subordinated claims on corporates PD shall be the bank's estimate of EL;
3. where the bank uses own LGD estimates for corporate exposures and it can decompose its EL estimates for purchased corporate receivables into PDs and LGDs in a reliable manner, the PD estimate may be used.

(3) The value of PD for defaulted exposures shall be 100%.

(4) In determining the values of PD parameter the bank may recognise unfunded credit protection.

(5) A bank using own LGD estimates may adjust PD by recognising protection with guarantees in accordance with Article 76, paragraph 1.

(6) For dilution risk of purchased corporate receivables, PD shall be set equal to EL estimate for dilution risk. If a bank uses own LGD estimates for corporate exposures and it can decompose its EL estimates for dilution risk of purchased corporate receivables into PDs and LGDs in a reliable manner, the PD estimate may be used. The bank may recognise unfunded credit protection in determining the PD value. A bank using own LGD estimates may adjust PD by recognising unfunded credit protection as per Article 76, paragraph 1.

Loss Given Default (LGD) for Exposures to Central Governments, Central Banks, Corporates and Institutions

Article 75. (1) A bank shall use the following LGD values:

1. senior exposures without eligible collateral: 45%;

2. subordinated exposures without eligible collateral: 75%;

3. (amended, Darjaven Vestnik, issue 21 of 2009; amended; Darjaven Vestnik, issue 102 of 2010, effective as of 1 January 2011) covered bonds as specified in Article 41, paragraphs 2–4: 11.25%;

4. for senior purchased corporate receivables exposures where the bank cannot demonstrate that its PD estimates meet the minimum requirements set out in Section Five *Minimum Requirements for Internal Rating Based Approach* of this Chapter, the LGD value shall be 45%;

5. for subordinated purchased corporate receivables exposures where the bank cannot demonstrate that its PD estimates meet the minimum requirements set out in Section Five *Minimum Requirements for Internal Rating Based Approach* of this Chapter, the LGD value shall be 100%;

6. for purchased corporate receivables for dilution risk: 75%.

(2) Banks may recognise unfunded credit protection in determining LGD.

(3) For dilution and default risk if a bank uses own LGD estimates for corporate exposures and it can distinguish PD and LGD parameters in a reliable manner, the LGD estimate for purchased receivables shall be used.

PD and LGD Estimates with Existing Credit Protection

Article 76. (1) Subject to BNB approval under Article 57, paragraph 5, a bank using own LGD estimates may adjust PD or LGD if guaranteed credit protection exists and provided the minimum requirements as specified in Section Five *Minimum Requirements for Internal Rating Based Approach* of this Chapter are in place. The adjusted PD or LGD for third party guaranteed exposure shall not lead to more favourable risk weight compared to a direct exposure to the guarantor.

(2) In relation to Article 63, paragraph 5, the LGD of a comparable direct exposure to the protection provider shall either be the LGD associated with an unhedged facility to the guarantor or the unhedged facility of the obligor. The choice of a variant shall depend upon circumstances evidencing that in the event both the guarantor and obligor default, the amount recovered would depend on the financial condition of the guarantor or obligor, respectively.

Effective Maturity (M)

Article 77. (1) A bank which does not use own estimates for LGD shall assign to exposures arising from repurchase transaction or securities or commodities lending or borrowing transaction a maturity value of 0.5 years and to all other exposures an M of 2.5 years.

(2) A bank that uses own LGDs and own conversion factors for exposures to central governments and central banks, corporates and institutions shall calculate M for each of these exposures in accordance with the following requirements:

1. for instruments subject to a cash flow schedule, M shall be calculated according to Formula 12 of Appendix 4 *IRB Approach*;

2. for derivatives subject to master netting agreements, M shall be the weighted average remaining maturity of the exposure, where M shall be at least 1 year and the notional amount of each exposure shall be used for weighting the maturity;

3. for exposures arising from fully or nearly-fully collateralised derivative instruments (listed in Appendix 1 *List of Derivatives*) transactions and fully or nearly-fully collateralised margin lending transactions which are subject to master netting agreements, M shall be the weighted average remaining maturity of the exposure but not less than 10 days, and the notional amounts of the exposures shall be used for weighting the maturity;

4. (new; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) for exposures arising from repurchase transactions or securities or commodity lending or borrowing transactions which are subject to a master netting agreement, M shall be the weighted average remaining maturity of the exposure where M shall be at least 5 days and the notional amount of each transaction shall be used for weighting the maturity;

5. (former item 4; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) for purchased corporate receivables, if a bank is permitted to use own PD estimates for purchased corporate receivables, for drawn amounts M shall equal the purchased receivables exposure weighted average maturity, where M shall be at least 90 days; this same value of M shall also be used for undrawn amounts under a committed purchase facility provided the facility contains effective covenants, early amortisation triggers, or other features that protect the purchasing bank against a significant deterioration in the quality of the future receivables it is required to purchase over the facility's term; when there is no such effective protections, M for undrawn amounts shall be calculated as the sum of the original term of the longest-dated potential receivable under the purchase agreement and the remaining maturity of the purchase facility, where M shall be at least 90 days;

6. (former item 5; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) a bank using the Internal Model Method set out in Section Six *Internal Model Based Method* of Chapter Eight *Treatment of Counterparty Credit Risk* shall calculate M for exposures included in the internal model in accordance with Formula 13 of Appendix 4 *IRB Approach* provided the maturity of the longest-dated contract contained in the netting set is greater than one year;

7. (former item 6; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) for netting sets in which all contracts have an original maturity of less than one year M is calculated in accordance with Formula 12 of Appendix 4 *IRB Approach*;

8. (former item 7; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) for any other instrument than those mentioned in this Article or when the bank is not in a position to calculate M as set out in item 1, M shall be the maximum remaining time (in years) that the obligor is permitted to take to fully discharge its contractual obligations, where M shall be at least 1 year;

(3) Subject to BNB approval, a bank using an internal model to calculate a one-sided credit valuation adjustment may use the effective credit duration estimated by the internal model instead of the M under paragraph 2, item 6;

(4) For the purposes of Formula 6 of Appendix 4 *IRB Approach,* M shall be the effective maturity of credit protection but not less than 1 year;

(5) The effective maturity (M) shall not be above 5 years.

(6) The effective maturity (M) shall be at least 1 day for:

1. (amended; Darjaven Vestnik, issue 38 of 2008, effective as of 11 April 2008) fully or nearly-fully collateralised derivatives listed in Appendix 1 *List of Derivatives;*

2. fully or nearly-fully collateralised margin lending transactions; and

3. repurchase transactions, securities or commodities lending or borrowing transactions.

(7) For the instruments under paragraph 6, the contract shall require daily revaluation of the exposure and daily re-margining, and shall include provisions that allow for the prompt liquidation or set-off of collateral in the event of default or failure to re-margin.

(8) Maturity mismatches in respect of exposure and related collateral shall be treated as specified in Chapter Six *Credit Risk Mitigation*.

Probability of Default (PD) for Retail Exposures

Article 78. (1) The probability of default (PD) of a retail exposure shall be at least 0.03%, and for exposures in default shall be 100%.

(2) For dilution risk of purchased receivables PD shall be set equal to EL estimates for dilution risk. If a bank can decompose its EL estimates for dilution risk of purchased receivables into its constituent parameters PDs and LGDs, the PD estimate may be used.

(3) (amended; Darjaven Vestnik, issue 38 of 2008, effective as of 11 April 2008) In determining the PD parameter unfunded credit protection may be recognised as eligible in accordance with the provisions of Article 79, paragraph 3. For dilution risk, where the bank do not use own estimates of LGDs, this shall be subject to compliance with the provisions of Chapter Six *Credit Risk Mitigation*.

LGD for Retail Exposures

Article 79. (1) LGD for dilution risk of purchased receivables shall be 75%. If a bank can decompose its EL estimates for dilution risk of purchased receivables into PDs and LGDs in a reliable manner, the LGD estimate may be used.

(2) Notwithstanding paragraph 1, a bank may use own LGD estimates, subject to BNB approval under Article 57, paragraph 5, provided the requirements of Articles 115 – 117 are met.

(3) Subject to BNB approval under Article 57, paragraph 5, in determining the values of the PD and LGD parameters a bank may recognise a credit protection guaranteeing individual exposures or a group of exposures in compliance with the provisions of Articles 115 – 117. The adjusted risk weights of guaranteed exposures, established on the basis of adjusted PD and LGD, shall not be lower than those of a comparable, direct exposure to the guarantor.

(4) With regard to Article 64, paragraph 3, the LGD of a comparable direct exposure to the protection provider shall either be the LGD assigned to an unhedged facility by the guarantor or the unhedged facility to the obligor. The choice of a variant shall depend upon whether, in the event both the guarantor and obligor default, available evidence indicates that the amount recovered would depend on the financial condition of the guarantor or obligor, respectively.

PD Estimates under the Application of PD/LGD Method, Subject to Equity Exposures

Article 80. (1) PDs shall be determined according to the principles for corporate exposures.

(2) For equity exposures the following minimum PDs shall apply:

1. 0.09% for exchange traded equity exposures where the investment is part of a long-term customer relationship;
2. 0.09% for non-exchange traded equity exposures where the returns on the investment are based on regular and periodic cash flows not derived from capital gains;
3. 0.40% for exchange traded equity exposures, other than those in item 1, including other short positions as set out in Article 66, paragraphs 2 and 3;
4. 1.25% for all other instruments, including other short positions within the meaning of Article 66, paragraphs 2 and 3;

LGD and M estimates under the Application of PD/LGD Method, Subject to Equity Exposures

Article 81. (1) Private equity exposures in sufficiently diversified portfolios may be assigned an LGD of 65%.

(2) All other exposures shall be assigned an LGD of 90%.

(3) M assigned to all exposures shall be 5 years.

Section Four
EXPOSURE VALUE

Exposures to Central Governments, Central Banks, Corporates, Institutions and Retail Exposures

Article 82. (1) The exposure value of on-balance sheet exposures to central governments, central banks, corporates, institutions and retail exposures shall be measured gross of value adjustments. This rule also applies to assets purchased at a premium or discount of their nominal value.

(2) Where the bank uses master netting agreements in relation to repurchase agreements or securities or commodities lending/borrowing transactions, the exposure value shall be calculated in accordance with Chapter Six *Credit Risk Mitigation*.

(3) For on-balance sheet netting of loans and deposits, banks shall apply for the calculation of the exposure value the methods set out in Chapter Six *Credit Risk Mitigation*.

(4) The exposure value for leases shall be the present value of minimum lease payments. Minimum lease payments shall also include any guaranteed residual value fulfilling the set of eligibility conditions for protection providers in Article 143, as well as the minimum requirements for recognising other types of guarantees provided in Articles 146 – 148.

(5) For items from the *List of Derivatives* in Appendix 1, the exposure value shall be determined by the methods set out in Chapter Eight *Treatment of Counterparty Credit Risk*.

(6) The exposure value for purchased receivables shall be the outstanding amount of such exposures minus the capital requirements for dilution risk prior to the recognition of credit protection.

Exposures in Securities or Commodities Underlying Repurchase Transactions or Securities or Commodities Lending or Borrowing Transactions, Long Settlement Transactions and Margin Lending Transactions

Article 83. (1) Where an exposure takes the form of securities or commodities underlying repurchase transactions or securities or commodities lending or borrowing transactions, long settlement transactions and margin lending transactions, the exposure value shall be determined in accordance with the accounting policy.

(2) Where the bank applies the Financial Collateral Comprehensive Method as set out in Chapter Six *Credit Risk Mitigation*, the exposure value shall be increased by the price volatility adjustment appropriate to such securities or commodities. The exposure value of repurchase transactions, securities or commodities lending or borrowing transactions, long settlement transactions and margin lending transactions

shall be determined in accordance with Chapter Eight *Treatment of Counterparty Credit Risk* or as per Articles 84 – 87.

(3) Unless the principles of paragraph 2 provide to the contrary, the exposure value of a credit risk exposure to a central counterparty shall be determined in accordance with Article 236, provided that the central counterparty's counterparty credit risk exposures to all participants in all its arrangements are fully collateralised on a daily basis.

Conversion Factors for Certain Exposures

Article 84. (1) The exposure value for the following items shall be calculated as the committed but undrawn amount multiplied by a conversion factor:

1. a 0% conversion factor for credit lines that are unconditionally cancellable at any time without prior notice, or that effectively provide for automatic cancellation due to deterioration in a borrower's credit worthiness. The bank shall actively monitor the financial condition of the obligor, and its internal control systems shall enable it to immediately detect a deterioration in the credit quality of the obligor. Undrawn retail credit lines may be considered as unconditionally cancellable if the contractual terms permit the bank to cancel them to the full extent allowable;
2. a 0% conversion factor for undrawn purchase commitments for revolving purchased receivables provided such commitments are unconditionally cancellable or that effectively provide for automatic cancellation at any time by the bank without prior notice; the bank shall actively monitor the financial condition of the obligor, and its internal control systems shall enable it to immediately detect a deterioration in the credit quality of the obligor;
3. a 20% conversion factor for exposures in short-term letters of credit issued or endorsed by the bank arising from commodity flow;
4. a 75% conversion factor for other credit lines and agreements of the NIF and RUF type.

(2) Subject to BNB approval under Article 57, paragraph 5, banks which meet the minimum requirements for the use of own estimates of conversion factors as specified in Section Five *Minimum Requirements for Internal Rating Based Approach* of this Chapter may use their own estimates of conversion factors for exposures as mentioned in the foregoing paragraph.

(3) Where a commitment leads to the extension of another commitment, the bank shall use the lower of the two conversion factors associated with the relevant individual commitments.

Conversion Factors for Other Exposures

Article 85. All off-balance sheet items, other than those mentioned in Articles 82 – 84, classified as per Appendix 2 *Classification of Off-balance Sheet Items* shall attract the following conversion factors:

1.100% if they are full risk items;

2. 50% if they are medium-risk items;
3. 20% if they are low-risk items; and
4. 0% if they are low-risk items.

Equity Exposures

Article 86. Equity exposures shall be measured as per the following principles:

1. for investments held at fair value with changes in value flowing directly through income and into own funds, the exposure value is the fair value presented in the bank's balance sheet;

2. for investments held at fair value with changes in value not flowing through income but into a separate component of equity, the exposure value is the fair value presented in the bank's balance sheet; and

3. for investments held at the lower of cost or market, the exposure value shall be the value presented in the bank's balance sheet.

Other Non-credit Obligation Assets

Article 87. The exposure value of other non credit-obligation assets shall be the value presented in the bank's balance sheet.

Section Five

MINIMUM REQUIREMENTS FOR INTERNAL RATING BASED APPROACH

Rating Systems

Article 88. (1) A "rating system" shall comprise all of the methods, processes, controls, data collection and IT systems employed in the assessment of credit risk, the assignment of exposures to grades or pools (rating), and the quantification of default and loss estimates for a certain type of exposure.

(2) The bank shall document the structure and the functional features of the rating systems employed.

(3) If a bank uses multiple rating systems, the rationale for assigning an obligor or a transaction to a rating system shall be documented and applied in a manner that appropriately reflects the level of risk.

(4) Assignment criteria and processes for assigning exposures to different rating systems shall be periodically reviewed to determine whether they remain appropriate for the current portfolio and external conditions.

(5) Where a bank uses direct estimates of risk parameters these may be seen as the outputs of grades on a continuous rating scale.

Structural Rating System for Exposures to Central Governments and Central Banks, Institutions and Corporates

Article 89. (1) A rating system shall take into account obligor and transaction risk characteristics.

(2) A rating system shall have an obligor rating scale, which reflects exclusively quantification of the risk of obligor default. The obligor rating scale shall have a minimum of 7 grades for non-defaulted obligors and one for defaulted obligors.

(3) An “obligor grade” shall mean a risk category within a rating system’s obligor rating scale, to which obligors are assigned on the basis of a specified and distinct set of rating criteria, from which estimates of PD are derived. A bank shall clearly document and indicate the relationship between obligor grades in terms of the level of default risk each grade implies and the criteria used to distinguish that level of default risk.

(4) Banks with portfolios concentrated in a particular market segment and range of default risk shall have enough obligor grades within that range to avoid undue concentrations of obligors in a particular grade.

(5) Significant concentrations within a single grade shall be supported by convincing empirical evidence that the obligor grade covers a reasonably narrow PD band and that the default risk posed by all obligors in the grade falls within that band.

Own LGD Estimates

Article 90. (1) (amended; Darjaven Vestnik, issue 38 of 2008, effective as of 11 April 2008) Subject to BNB approval under Article 57, paragraph 5, the bank may use its own LGD estimates to calculate the capital requirements.

(2) To qualify for recognition as per paragraph 1, the bank shall prepare and incorporate a distinct facility rating scale, which exclusively reflects LGD-related transaction characteristics.

(3) A “facility grade” shall mean a risk category within a rating system’s facility scale, to which exposures are assigned on the basis of a specified and distinct set of rating criteria from which own estimates of LGDs are derived. A bank shall document and describe how exposures are assigned to the relevant grade and the criteria used to distinguish the level of risk across grades.

(4) Significant concentrations within a single facility grade shall be supported by convincing empirical evidence that the facility grade covers a reasonably narrow LGD band, respectively, and that the risk posed by all exposures in the grade falls within that band.

(5) A bank assigning risk weights for specialised lending exposures as per Article 63, paragraph 7, the rating scale for such exposures shall include at least 4 grades for non-defaulted obligors and at least one grade for defaulted obligors.

Structure of the Rating System for Retail Exposures

Article 91. (1) The rating system for retail exposures shall reflect both obligor and transaction risk, and shall capture all relevant obligor and transaction characteristics.

(2) The level of risk differentiation shall ensure that the number of exposures in a given grade or pool is sufficient to allow for meaningful quantification and validation of the loss characteristics at the grade or pool level. The distribution of exposures and obligors across grades or pools shall be such as to avoid excessive concentrations.

(3) The bank shall demonstrate that the process of assigning exposures to grades or pools provides for a meaningful differentiation of risk, provides for a grouping of sufficiently homogenous exposures, and allows for accurate and consistent estimation of loss characteristics at grade or pool level. For purchased receivables the grouping shall reflect the seller's practices in handling its customers and their heterogeneity.

(4) Banks shall consider the following risk drivers when assigning exposures to grades or pools:

1. obligor risk characteristics;
2. transaction risk characteristics, including product or collateral types, as well as cases where several exposures benefit from the same collateral;
3. delinquency;
4. assignments to grades or pools.

Definitions, Processes and Criteria for Assigning Exposures to Grades or Pools

Article 92. (1) The bank shall have specific definitions, processes and criteria for assigning exposures to grades or pools within a rating system in compliance with the following requirements:

1. the criteria and definitions shall be sufficiently detailed to allow those charged with assigning ratings to consistently assign obligors or facilities posing similar risk to the same grade or pool. These assignments shall exist consistently across lines of business, departments and geographic locations;
2. documentation of the rating process shall allow third parties to understand the assignments of exposures to grades or pools, to replicate grade and pool assignments and to evaluate the appropriateness of the assignments to a grade or a pool; and
3. the criteria shall also be consistent with the bank's internal lending standards and its policies for handling troubled obligors and facilities.

(2) A bank shall take all relevant information into account in assigning obligors and facilities to grades or pools. Information shall be current and shall enable the bank to forecast the future performance of the exposure. The less information a bank

has, the more conservative shall be its assignments of exposures to obligor and facility grades or pools.

(3) If a bank uses an external rating as a primary factor determining an internal rating assignment, the bank shall ensure that it considers other relevant information.

Assignment of Exposures to Central Governments and Central Banks, Institutions and, Corporates to Risk Grades and Rating Pools

Article 93. (1) Each obligor shall be assigned by the bank to an obligor grade as part of the credit approval process.

(2) For a bank permitted to use own estimates of LGD or conversion factors, each exposure shall also be assigned to a facility grade as part of the credit approval process.

(3) A bank assigning risk weights for specialised lending exposures as per Article 63, paragraph 7 it shall assign each of these exposures to a grade in accordance with Article 90, paragraph 5.

(4) Each separate legal entity to which the bank is exposed shall be separately rated. The bank shall demonstrate to the BNB that it has acceptable policies regarding the treatment of individual obligor clients and groups of connected clients.

(5) Separate exposures to the same obligor shall be assigned by the bank to the same obligor grade, irrespective of any differences in the nature of each specific transaction with the exception of:

1. country transfer risk, this being dependent on whether the exposures are denominated in local or foreign currency;

2. where the treatment of associated guarantees to an exposure may be reflected in an adjusted assignment to an obligor grade; and

3. where a legal restriction prohibits the exchange of client data.

Assigning Retail Exposures to Risk Grades or Rating Pools

Article 94. Each retail exposure shall be assigned by the bank to a grade or a pool as part of the credit approval process.

Overrides

Article 95. For grade and pool assignments banks shall document the situations in which expert judgement may override the inputs or outputs of the assignment process and the personnel responsible for approving these overrides. In such cases the bank shall assess the subsequent performance of the exposures and the actions of the relevant responsible person.

Integrity of Assignment Process

Article 96. (1) (amended; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) Assigning exposures to risk categories and rating groups and the periodic review of this assignment shall be approved by an independent party or body that does not directly benefit from discussions to extend the credit.

(2) A bank shall update assignments to a risk grade or pool in relation to an obligor or facility at least annually, while high risk obligors and problem exposures shall be subject to more frequent review. The bank shall undertake a new assignment if material information on the obligor or exposure becomes available.

(3) A bank shall have an effective process to obtain and update relevant information on obligor characteristics and on transaction characteristics that affect PDs, LGDs and conversion factors.

(4) For retail exposures, a bank shall at least annually update the loss characteristics and delinquency status of each identified risk pool of similar features and shall review in a representative sample the status of individual exposures within each pool as a means of ensuring that exposures continue to be assigned to the correct pool.

Use of Models

Article 97. If a bank uses statistical models and other automated methods and models to assign exposures to obligors or facilities grades or pools, it shall comply with the following requirements:

1. the bank shall demonstrate to the BNB that the model has good predictive power and that capital requirements are not distorted as a result of its use; the input variables shall form a reasonable and effective basis for the resulting predictions; the model shall not have material biases;

2. the bank shall have in place a process for vetting data inputs into the model, which includes an assessment of the accuracy, completeness and appropriateness of the data;

3. the bank shall demonstrate that the data used to build the model are representative of the population of the bank's actual obligors or exposures;

4. the bank shall have a regular cycle of model validation that includes monitoring of model performance and stability; review of model specification; and testing of model outputs against outcomes;

5. the bank shall complement the statistical model by expert judgement and review of model-based assignments to ensure that the models are used appropriately; review procedures shall aim at finding and limiting errors associated with model weaknesses by taking into account all relevant information not considered by the model; the bank shall document how expert judgement and model results are to be combined.

Rating Systems Documentation

Article 98. (1) The bank shall document the design and operational details of its rating systems. The documentation shall evidence compliance with the minimum requirements in this Section, and address topics including portfolio differentiation, rating criteria, responsibilities of parties that rate obligors and exposures, frequency of assignment reviews, and management oversight of the rating process.

(2) The bank shall document the rationale for and analysis supporting its choice of rating criteria as well as all major changes in the risk rating process, and such documentation shall describe any changes made to the risk rating process subsequent to the last review by the BNB. The organisation and the process of rating assignment and the internal control structure shall also be documented.

(3) The bank shall document the specific definitions of default and loss used internally and shall demonstrate consistency with the definitions set out in this Ordinance.

(4) The employment of statistical models in the rating process by the bank shall be based on a documented methodology, which shall:

1. provide a detailed outline of the theory, assumptions and mathematical and empirical basis of the assignment of estimates to grades, individual obligors, exposures, or pools, and the data source(s) used to estimate the model;

2. establish a rigorous statistical process (including out-of-time and out-of-sample performance tests) for validating the model;

3. indicate any circumstances under which the model does not work effectively.

(5) The requirements as per paragraphs 1 – 4 shall also apply to models employed by the bank and obtained from third-party vendors that use proprietary technology.

Data Base Maintenance

Article 99. (1) Banks shall collect and store data on their internal ratings as required under requirements of Part Five *Disclosure requirements.*

(2) For exposures to central governments and central banks, institutions and corporates banks shall collect and store data as follows:

1. complete rating histories on obligors and recognised guarantors;

2. the dates the ratings were assigned;

3. the key data and methodology used to derive the rating;

4. the person responsible for the rating assignment;

5. the identity of obligors and exposures that defaulted;

6. the date and circumstances of such defaults; and

7. data on the predicted PDs and realised default rates associated with rating grades and ratings migration.

(3) A bank not using own estimates of LGDs or conversion factors shall collect and store data on comparisons of realised LGDs to the values as set out in Article 83, and realised conversion factors to the values as set out in Article 84.

(4) Banks not using own estimates of LGDs or conversion factors shall collect and store:

1. complete histories of data on the facility ratings and LGD and conversion factor estimates associated with each rating scale;

2. the dates the ratings were assigned and the estimates were done;

3. the key data and methodology used to derive the facility ratings and LGD and conversion factor estimates;

4. persons who assigned the facility rating and persons who provided LGD and conversion factor estimates;

5. data on the estimated and realised LGDs and conversion factors associated with each defaulted exposure;

6. data on the components of loss for each defaulted exposure.

(5) Banks that reflect the credit risk mitigating effects of guarantees or credit derivatives through LGD, shall store data on the LGD of the exposure before and after evaluation of credit protection.

(6) For retail exposures banks shall collect and store:

1. data used in the process of allocating exposures to grades or pools;

2. data on the estimated PDs, LGDs and conversion factors associated with grades or pools of exposures;

3. the identity of obligors and exposures that defaulted;

4. for defaulted exposures, data on the grades or pools to which the exposure was assigned over the year prior to default and the realised outcomes on LGD and conversion factor; and

5. data on loss rates for qualifying revolving retail exposures.

Stress Tests Used in Capital Adequacy Assessment

Article 100. (1) A bank shall have in place sound stress testing processes for use in the assessment of its capital adequacy. Stress testing shall involve identifying possible events or future changes in economic conditions that could have unfavourable effects on the bank's credit exposures and assessment of the bank's ability to withstand such changes.

(2) A bank shall regularly perform a credit risk stress test to assess the effect of certain specific conditions on its total capital requirements for credit risk. The test shall be subject to supervisory review.

(3) The test to be employed shall be meaningful and reasonably conservative, considering at least the effect of mild recession scenarios. The bank shall assess a potential migration in its ratings under the stress test scenarios. Stressed portfolios shall contain the vast majority of a bank's total exposure.

(4) Banks using the principles set out in Article 63, paragraph 5 shall consider as part of their stress testing framework the impact of a deterioration in the credit quality of protection providers, in particular the impact of protection providers falling outside the eligibility criteria.

Default Definition

Article 101. (1) A "default" shall be considered to have occurred with regard to a particular obligor when either or both of the two following events have taken place:

1. the bank considers that the obligor is unlikely to pay its credit obligations to the bank, the parent undertaking or any of its subsidiaries, without recourse to actions such as realising the collateral (if held);

2. the obligor is past due more than 90 days on any material credit obligation to the bank, the parent undertaking or any of its subsidiaries.

(2) For overdrafts, days past due commence once any of the following events has taken place:

1. obligor has breached materially a contractual limit;

2. the bank has decreased materially the limit in amount smaller than the amount drawn by the obligor;

3. obligor has drawn credit without authorisation by the bank.

(3) The materiality threshold shall be:

1. under paragraph 1 – 10% of the current payment due;

2. under paragraph 2 – 10% of the contractual limit.

(4) Days past due for credit cards shall commence on the date following the minimum payment due date.

(5) In the case of retail exposures and exposures to public sector entities the bank shall apply paragraph 1 at a transaction level.

Main Elements Indicating "Unlikelihood to Pay"

Article 102. (1) Elements to be taken as indications of unlikelihood to pay as per Article 101, paragraph 1, item 1 shall include:

1. the bank puts the credit obligation on non-accrued status;

2. (amended; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) the bank makes a value adjustment resulting from a perceived decline in credit quality of the exposure;

3. the bank sells the credit obligation at a material credit-related economic loss due to its deteriorated credit quality;

4. (amended; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) as a result of declined financial standing and solvency of the obligor, the bank consents to a distressed restructuring of the credit obligation by giving forgiveness, or postponement, of principal, interest and fees; this includes also equity exposures assessed under the PD/LGD Approach;

5. the bank has filed for the obligor's bankruptcy or liquidation in respect of an obligor's credit obligation to the bank, the parent undertaking or any of its subsidiaries; and

6. the obligor has sought or has been placed in bankruptcy or liquidation where this would avoid or delay repayment of a credit obligation to the bank, the parent undertaking or any of its subsidiaries.

Specific Rules for Default Data

Article 103. (1) A bank that uses external data that is not itself consistent with the definition of default as per Article 101, paragraph 1 shall demonstrate to the BNB that appropriate adjustments have been made to achieve broad equivalence with the definition of default.

(2) If the bank considers that a previously defaulted exposure is such that no trigger of default continues to apply as per Article 101, the bank shall rate the obligor or facility as it would for a non-defaulted exposure. Should the definition of default as per Article 101 subsequently be triggered, another default would be deemed to have occurred.

Overall Requirements for Estimation

Article 104. (1) A bank's own estimates of the risk parameters PD, LGD, conversion factor and EL shall incorporate all relevant data, information and methods. The estimates shall be derived using both historical experience and empirical evidence, and not based purely on judgemental considerations. The estimates shall be plausible and intuitive and shall be based on the material drivers of the respective risk parameters. The less data a bank has, the more conservative it shall be in its estimation.

(2) The bank shall be able to provide a breakdown of its loss experience in terms of default frequency, LGD, conversion factor, or loss where EL estimates are used, by the factors it sees as the drivers of the respective risk parameters. The bank shall demonstrate that its estimates are representative of long run experience.

(3) In the course of estimation, any changes in its lending practice or the process for pursuing recoveries over the observation periods referred to in Articles 106, 109, 111, 113, paragraph 1, and Article 114 shall be taken into account. The bank's estimates shall be reviewed and updated at least annually to reflect new information.

(4) The population of exposures represented in the data used for estimation, the lending standards used when the data was generated and other relevant characteristics shall be comparable with those of the bank's total exposures and internal rules. The bank shall also demonstrate that the economic or market conditions that underlie the data are relevant to current and foreseeable market conditions. The number of exposures in the sample and the data period used for quantification shall be sufficient to provide the bank with confidence in the accuracy and robustness of its estimates.

(5) For purchased receivables the estimates shall reflect all relevant information available to the purchasing bank regarding the quality of the underlying receivables, including data for similar pools provided by the seller, by the purchasing bank, or by external sources. The purchasing bank shall evaluate any data relied upon which is provided by the seller.

(6) A bank shall adjust its estimates with a margin related to the expected range of estimation errors. Where methods and data are less satisfactory and the expected range of errors is larger, the margin of conservatism shall be larger.

(7) If a bank uses different estimates for the calculation of risk weights for prudential and internal purposes, these shall be documented and their reasonableness shall be approved by the BNB.

(8) If a bank can demonstrate to the BNB that for data that have been collected prior to the date of implementation of this Ordinance appropriate adjustments have been made to achieve broad equivalence with the definitions of default or loss as per Article 101, then the estimates based on such data shall be recognised by the BNB.

(9) If a bank uses data that refers to other banks it shall demonstrate that:

1. the rating systems and criteria of these other banks in the pool are similar with its own;

2. the pool is representative of the portfolio for which the pooled data is used; and

3. the pooled data is used consistently over time by the bank for its risk parameters.

(10) If a bank uses data as per paragraph 9, it shall ensure the integrity of its rating systems. The bank shall prove to the BNB that it has sufficient understanding of and applies properly its rating systems, including effective ability to monitor and audit the rating process.

Requirements Specific to PD Estimation for Exposures to Central Governments, Central Banks, Institutions and Corporates

Article 105. (1) A bank shall estimate PDs by obligor grade from long run averages of one-year default rates.

(2) For purchased corporate receivables the bank may estimate ELs by obligor grade from long run averages of one-year realised default rates.

(3) If a bank derives long run average estimates of PDs and LGDs for purchased corporate receivables from an estimate of EL, and an appropriate estimate of PD or LGD, the process for estimating total losses shall meet the requirements for estimation of PD and LGD set out in this Section, and the outcome for LGD shall be consistent with the requirement as set out in Article 110, paragraph 1.

(4) A bank shall use PD estimation techniques with supporting analysis, which takes into account expert considerations in combining results of relevant approaches and evaluation of their applicability. To the extent that a bank uses data on internal default experience for the estimation of PDs, it shall demonstrate in its analysis that the estimates are reflective of its internal lending rules and of any differences in the rating system that generated the data and the current rating system. Where lending rules or rating systems have changed, the bank shall add a greater margin of conservatism in its estimate of PD.

(5) Where a bank estimates default levels by mapping its internal grades to the scale used by an ECAI or an ECA, it shall map such external ratings of default and risk grades to its own in keeping with the following requirements:

1. the process of mapping shall be based on a comparison of internal rating criteria with the criteria used by the external organisation and on a comparison of the internal ratings of one and the same obligors;

2. the process of mapping of ratings and data used shall be unbiased and in line with internal practices and appropriately documented;

3. the external organisation's criteria underlying the data used for quantification shall be oriented to default risk only and not reflect transaction characteristics;

4. the bank's analysis shall include a comparison with and documentation of the default definitions used by the external agencies vis-a-vis the requirements of Article 101.

(6) Where a bank uses statistical default prediction models it shall estimate PDs as the simple average of default-probability estimates for individual obligors in a given grade and in compliance with the requirements of Article 97.

Length of the Historical Observation Period for PD Estimation for Central Governments and Central Banks, Institutions and Corporates

Article 106. The length of the historical observation period for its PD estimation used shall be at least five years for at least one source, irrespective of the type of data source. If the observation period spans a longer period for any source, and this data is relevant, this longer period shall be used. This requirement under paragraph 1 also applies to the PD/LGD Approach to equity.

Specific Requirements for PD Estimates for Retail Exposures

Article 107. (1) A bank shall estimate PDs by obligor grade or pool from long run averages of one-year default rates.

(2) PD estimates under paragraph 1 may also be derived from realised losses and appropriate estimates of LGDs.

Use of Internal and External Data for PD Estimates for Retail Exposures

Article 108. (1) A bank shall use internal data for assigning exposures to grades or pools as the primary source of information for estimating loss characteristics.

(2) Use of external data or statistical models shall be permitted provided the bank is able to demonstrate a strong link between:

1. the bank's internal process of assigning exposures to grades or pools and the process used by the external data source;

2. the bank's internal risk profile and the composition of the external data.

(3) For purchased retail receivables, a bank may use internal and external reference data as points of comparison.

(4) If a bank derives long run average estimates of PD and LGD for retail from an estimate of expected losses and an appropriate estimate of PD or LGD, the process for estimating total losses shall meet the overall standards for estimation of PD and

LGD set out in this Section, and the outcome shall be consistent with the concept of LGD as set out in Article 110, paragraph 1.

(5) A bank shall identify and analyse expected changes of risk parameters that are due to seasoning effects.

Length of the Historical Observation Period for PD Estimates for Retail Exposures

Article 109. The length of the historical observation period used to estimate PD shall be at least five years for at least one source irrespective of the data source. If the observation spans a longer period for any source, and these data are relevant, this longer period shall be used. The bank may use historical data if it can convince the BNB that more recent data is a better predictor of loss rates.

Requirements Specific to Own LGD Estimates

Article 110. (1) A bank shall estimate LGDs by facility grade or pool on the basis of the average realised LGDs by facility grade or pool using all observed defaults within the data sources.

(2) A bank shall use LGD estimates that are appropriate for an economic downturn if those are more conservative than the long-run average. To the extent a rating system is expected to deliver LGDs at a relatively constant level by grade or pool over time, adjustments shall be made to the estimates to limit the capital impact of an economic downturn.

(3) A bank shall consider the extent of any dependence between the risk of the obligor with that of the collateral or collateral provider. Cases where there is a significant degree of dependence shall be addressed in a conservative manner.

(4) Currency mismatches between the underlying obligation and the collateral shall be treated conservatively in the bank's assessment of LGD.

(5) In the event of collateral LGD estimates shall not solely be based on the collateral's estimated market value but shall also take into account the effect of the bank's potential inability to expeditiously gain control of this collateral and liquidate it.

(6) To take into account the existence of collateral, a bank shall establish internal rules for collateral management, legal certainty and risk management that are consistent with the requirements set out in Chapter Six *Credit Risk Mitigation*.

(7) Where a bank recognises collateral for determining the exposure value for counterparty credit risk according to Chapter Eight, Section Five *Standardised Approach* and Six *Internal Models Method*, this collateral shall not be taken into account in the LGD estimates.

(8) For an exposure already in default, a bank shall use its best estimate of expected loss under the current economic circumstances while taking into account the exposure status and the possibility of additional unexpected losses during the recovery period.

(9) Unpaid late fees capitalised in the bank's income statement shall be added to the bank's measure of exposure and loss.

Own Estimates for LGD for Central Governments and Central Banks, Institutions and Corporates

Article 111. Own estimates of LGD for exposures to central governments, central banks, institutions and corporates shall be based on data over a minimum of five years and for at least one data source. Data shall increase by one year each year after implementation of the IRB Approach until a minimum of seven years for that particular source is reached. If the available observation period spans a longer period for any source, this longer period shall be used.

Own Estimates for LGD for Retail Exposures

Article 112. (1) (amended; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) LGD estimates of retail exposures may be derived from realised losses and appropriate estimates of PDs.

(2) A bank may reflect in its LGD estimates future drawings unless it applies the treatment in Article 113, paragraph 3.

(3) For purchased retail receivables a bank may use internal and external data to estimate LGDs.

(4) Estimates of LGD shall be based on data over a minimum of five years' period of observation for at least one source, irrespective of the type of the data source. Where the period of observation for a source of relevant data is longer, the bank shall use the longer period. The bank may use historical data if it can demonstrate to the BNB that more recent data is a better predictor of loss rate over at least five years.

Requirements Specific to Own Conversion Factor Estimates

Article 113. (1) Banks shall estimate conversion factors by transaction grade or pool on the basis of the average realised conversion factors by transaction grade or pool using all observed defaults within the data sources.

(2) Banks shall use conversion factor estimates that are appropriate for an economic downturn if those are more conservative than the long-run average. To the extent a rating system is expected to deliver conversion factors at a relatively constant level by grade or pool over time, banks shall make adjustments to their estimates of risk parameters by grade or pool to limit the capital impact of an economic downturn.

(3) A bank's estimates of conversion factors shall reflect the possibility of additional drawings by the obligor up to and after the time a default event is triggered. The conversion factor estimate shall incorporate a larger margin of conservatism where a stronger positive correlation can reasonably be expected between the default frequency and the magnitude of conversion factor.

(4) In arriving at estimates of conversion factors a bank shall consider its policy and strategy adopted in respect of account monitoring and payment processing. The

bank shall also consider its ability and willingness to prevent further drawings in circumstances close to default, such as covenant violations or other technical default events.

(5) A bank shall have adequate systems and procedures in place to monitor facility amounts, relative share of draw downs against committed lines and changes in draw downs per obligor and per grade on a daily basis.

(6) If a bank uses different estimates for the calculation of conversion factors for prudential or internal purposes these shall be documented and their reasonableness shall be demonstrated to the BNB.

Length of the Historical Observation Period for Own Estimates for Conversion Factors

Article 114. (1) Estimates of conversion factors for exposures to central governments, central banks, institutions and corporates shall be based on data over a minimum of five years for at least one data source. Data shall increase by one year each year after implementation of the IRB Approach until a minimum of seven years is reached for a particular source. Where the observation period spans a longer period for any source, the bank shall use the longer period.

(2) Estimates of conversion factors for retail exposures shall be based on historical data over a period of observation of a minimum of five years for at least one source irrespective of the type of the data source. Where the observation period spans a longer period for any source of relevant data, the bank shall use the longer period. The bank may use historical data if it can demonstrate to the BNB that more recent data is a better predictor of future draw downs.

Minimum Requirements for Estimating the Effect of Guarantees and Credit Derivatives

Article 115. (1) A bank shall have clearly specified criteria for the types of guarantors it recognises for the calculation of risk weighted exposure amounts.

(2) For recognised guarantors the same rules as for obligors as set out in Articles 92 – 96.

(3) The guarantee shall be non-cancellable on the part of the guarantor, in force until the obligation is satisfied, evidenced in writing and legally enforceable against the guarantor in a jurisdiction where the guarantor has assets underlying the guarantee. The bank shall demonstrate that the criteria as per paragraph 1 adequately addresses any potential risk of reduction in the amount of protection.

(4) A bank shall have clearly specified criteria for adjusting grades, pools or LGD estimates and the risk weighted exposure amounts which reflect the impact of guarantees. These criteria shall comply with the minimum requirements set out in Articles 92 – 96.

(5) The criteria shall be plausible and shall take into account the guarantor's ability and willingness to perform under the guarantee, the likely timing of any payments

from the guarantor, the degree to which the guarantor's ability to perform under the guarantee is correlated with the obligor's ability to repay, and the extent to which residual risk to the obligor remains.

Minimum Requirements for Estimating the Effect of Credit Derivatives

Article 116. (1) (amended; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) The minimum requirements for guarantees under Article 115 shall apply also for single-name credit derivatives. In relation to a mismatch between the underlying obligation and the reference obligation of the credit derivative or the obligation used for determining whether a credit event has occurred, the requirements set out in Article 150 shall apply. These requirements shall also apply to the process of allocating retail exposures and purchased receivables to grades or pools.

(2) The criteria shall conservatively address the pay-out structure of the credit derivative and assess the impact this has on the level and timing of recoveries and residual risk.

Exposures to Central Governments and Central Banks, Institutions, Corporates and Retail Exposures where Own Estimates of LGD are used

Article 117. (1) (amended; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010; amended; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) The requirements under Articles 115 and 116 shall not apply to guarantees provided by institutions, central governments and central banks, as well as corporates under Article 143, paragraph 1, item 7 which meet the requirements laid dawn in Article 143, paragraph 2 if the bank has received un approval to apply the rules of Chapter Four *Standardised Approach* for exposures to such entities. In this case, the requirements of Chapter Six *Credit Risk Mitigation* shall apply.

(2) For retail guarantees, the requirements of paragraph 1 also apply to the assignment of exposures to grades or pools, and the estimation of PD.

Minimum Requirements for Purchased Receivables

Article 118. (1) The legal aspects of the purchased receivables transaction shall ensure that under all foreseeable circumstances the bank has effective ownership and control of all cash remittances from the receivables. When the obligor makes payments directly to a seller or servicer, the bank shall verify regularly that payments are forwarded completely and within the contractually agreed terms. The bank shall have appropriate legal procedures to ensure that ownership over the receivables and cash receipts is protected against bankruptcy stays or legal challenges that could materially delay the lender's ability to liquidate or assign the receivables or retain control over cash receipts.

(2) Within the meaning of paragraph 1 "servicer" shall mean an entity that manages a pool of purchased receivables or the underlying credit exposures on a day-to-day basis.

Effectiveness of Monitoring Systems

Article 119. (1) The bank shall monitor both the quality of the purchased receivables and the financial condition of the seller and servicer by means of:

1. assessing the correlation among the quality of the purchased receivables and the financial condition of both the seller and servicer, and having in place internal policies and procedures that provide adequate safeguards to protect against any contingencies, including the assignment of an internal risk rating for each seller and servicer;
2. having clear and effective policies and procedures for determining seller and servicer eligibility; the bank or its agents shall conduct periodic reviews of the reports submitted by sellers and servicers in order to detect fraud or operational weaknesses, and verify the quality of the seller's credit policies and servicer's collection procedures; the findings of these reviews shall be documented;
3. assessing the characteristics of the purchased receivables pools; history of the seller's arrears, non-performing debts, and non-performing debt allowances; payment terms, and potential contra accounts;
4. having effective rules and procedures for monitoring on an aggregate basis single-obligor concentrations both within and across purchased receivables pools;
5. ensuring timely and sufficiently detailed reports of receivables ageings and dilutions to ensure compliance with the bank's criteria governing purchased receivables, and providing an effective means with which to monitor and confirm the seller's terms of sale and dilution.

(2) The bank shall have systems and procedures for detecting deteriorations in the seller's financial condition and purchased receivables quality at an early stage, and for addressing emerging problems pro-actively. The bank shall have effective rules, procedures, and information systems to monitor covenant violations, and clear and effective policies and procedures for initiating legal actions and dealing with problem purchased receivables.

(3) The bank shall have clear and effective rules and procedures governing the control of purchased receivables, credit, and cash. The internal rules shall specify all material elements of the receivables purchase programme, including amount of advance payments to seller, eligible collateral, necessary documentation, concentration limits, and the way cash receipts are to be handled. These elements shall take account of all relevant and material factors, including the seller and servicer's financial condition, risk concentrations, and trends in the quality of the purchased receivables and the seller's customer base. The internal systems shall ensure that funds are advanced only against specified supporting documentation and collateral.

(4) The bank shall have an effective internal process for assessing compliance with all internal rules and procedures, which shall include:

1. regular audits of all critical phases of the bank's receivable purchase programme;
2. verification of the separation of duties with regard to the assessment of the seller and servicer and the assessment of the obligor;
3. verification of the separation of duties with regard to the assessment of the seller and servicer and the field audit;
4. evaluations of back office operations, qualifications and experience of the staff, and of the supporting automation systems.

Validation of Internal Estimates

Article 120. (1) A bank shall have robust systems in place to validate the accuracy and consistency of rating systems, processes, and the estimation of all relevant risk parameters. A bank shall demonstrate to the BNB that the internal validation process enables it to assess the performance of internal rating and risk estimation systems consistently and meaningfully.

(2) A bank shall regularly compare the expected PDs with the realised default rates for each grade and, where realised default rates are outside the expected allowable range for that grade, the bank shall analyse the reasons for the deviation. Where own estimates of LGDs and/or conversion factors are being used, banks shall also perform analogous analysis. Such comparisons shall make use of time series of historical data that cover as long periods as possible, and the methods and data used in such comparisons shall be documented and updated at least annually.

(3) A bank shall also use other quantitative validation tools and comparisons with relevant external data sources. The data used shall be appropriate for the portfolio, shall be updated regularly, and shall cover a relevant observation period. The internal assessments of the performance of their rating systems shall be based on as long a period as possible.

(4) The methods and data used for quantitative validation shall be consistent through time. Changes in estimation and validation methods and data shall be documented.

(5) Where own estimates of EL are used, a bank shall have in place sound internal standards for situations where deviations of the realised PDs, LGDs, or conversion factors from the expected ones are significant enough to call the validity of the estimates into question. These standards shall take account of business cycles and systematic variability in default levels. Where realised values continue to be higher than expected values, estimates shall be revised upward to reflect the default and loss historical data.

Calculation of Risk Weighted Exposure Amounts for Equity Exposures under the Internal Models Approach

Article 121. For the purpose of calculating capital requirements by means of internal models, the following conditions and standards shall be met:

1. the estimate of potential loss shall be robust to adverse market movements impacting the long-term risk profile of the bank's portfolios;

2. the data used to establish return distributions shall reflect the longest sample period for which data is available and meaningful in representing the risk profile of the equity exposures;

3. the data used shall provide conservative, statistically reliable and robust loss estimates that are not based purely on subjective or judgmental considerations;

4. a bank shall demonstrate to the BNB that the shocks employed in the stress tests provide a conservative estimate of potential losses over a relevant long-term market or business cycle;

5. the bank shall combine empirical analysis of available data with adjustments based on a variety of factors in order to attain sufficiently realistic and conservative model outputs;

6. in constructing Value at Risk (VaR) models estimating potential quarterly losses, a bank shall use quarterly data or convert shorter horizon period data to a quarterly equivalent using an analytically appropriate method supported by empirical evidence and through a well-developed and documented thought process and analysis; such an approach shall be applied conservatively and consistently over time, and with a higher degree of conservatism where the available data are limited;

7. the models used shall be able to capture adequately all of the material risks relating to equity returns including both the general and specific market risk entailed in the exposures; the internal models shall adequately explain historical price variation, capture both the magnitude and changes in the composition of potential concentrations, and be robust to adverse market environments; the population of risk exposures represented in the data used for estimation shall be closely matched to or at least comparable with the bank's equity exposures;

8. the internal model shall be appropriate for the risk profile and complexity of a bank's equity portfolio; where a bank has material holdings with values that are highly non-linear in nature, the internal models shall be designed to capture appropriately the risks associated with such instruments;

9. mapping of individual positions to proxies, market indices, and risk factors shall be plausible, intuitive, and conceptually sound;

10. a bank shall demonstrate through empirical analyses the appropriateness of risk factors, including their ability to cover both general and specific risk;

11. the estimates of the return volatility of equity exposures shall incorporate relevant and available data, information, and methods. Independently reviewed internal data or data from external sources shall be used;

12. a rigorous and comprehensive stress-testing programme shall be in place.

Rules, Processes and Controls for Calculating the Capital Requirement for Equity Exposures

Article 122. With regard to the development and use of internal models for capital requirement purposes, banks shall establish policies, procedures, and controls to ensure the integrity of the model and modelling process, which shall include the following:

1. the internal model shall be fully integrated into the overall management information systems of the bank and in the management of the non-trading book equity portfolio; the model shall be fully integrated into the bank's risk management infrastructure where it is used in measuring and assessing equity portfolio performance (including and excluding the risk-adjusted performance), in allocating economic capital to equity exposures and in evaluating the overall capital adequacy and the investment management process;

2. establishing management systems, procedures, and control functions for ensuring the periodic and independent review of all elements of the internal modelling process, including approval of model revisions, vetting of model inputs, and review of model results (such as direct verification of risk computations); these reviews shall assess the accuracy, completeness, and appropriateness of model inputs and results and focus on both finding and limiting potential errors associated with known weaknesses and identifying unknown model weaknesses; such reviews may be conducted by an independent internal unit, or by an independent external third party;

3. adequate systems and procedures for monitoring investment limits and the risk exposures of equity instruments;

4. the units responsible for the design and application of the model shall be functionally independent from the units responsible for managing individual investments; and

5. parties responsible for any aspect of the modelling process shall have the adequate qualification and competencies.

Validating and Documenting the Internal Models for Calculating the Capital Requirements for Equity Exposures

Article 123. (1) A bank shall have a robust system in place to validate the accuracy and consistency of the internal models and modelling processes, and all material elements shall be documented. The internal validation shall include a consistent and comprehensive assessment of the internal models and modelling processes.

(2) The methods and data used for quantitative validation shall be consistent through time, whereas any change therein shall be documented.

(3) A bank shall regularly compare and document actual equity returns (including realised and unrealised gains and losses) with modelled estimates, making use of

historical data that cover as long a period as possible. Analyses and documentation shall be updated at least annually.

(4) A bank shall approve and by making use of other quantitative validation tools compare with external data sources. The data used shall be appropriate to the portfolio, shall be updated regularly, and shall cover a relevant observation period. The internal assessments of the performance of the models shall be based on as long a period as possible.

(5) A bank shall have sound internal standards for situations where comparison of actual equity returns with the models estimates calls the validity of the estimates or of the models as such into question. These standards shall take account of business cycles and similar systematic variability in equity returns. The adjustments made in response to model reviews shall be documented.

(6) The internal model documentation shall also cover the responsibilities of the parties involved in the modelling, review and approval processes.

Corporate Governance

Article 124. (1) All material aspects of the rating and estimation processes shall be approved by the management body or persons authorised by it. These shall possess a general understanding of the bank's rating systems and detailed comprehension of its associated management reports.

(2) Senior management shall provide notice to the management body or the persons authorised by it of material changes or exceptions from established policies that will materially impact the bank's rating systems.

(3) Senior management shall have a good understanding of the rating systems designs and operations, and shall monitor on an ongoing basis that the rating systems are operating properly. Senior management shall be regularly informed by the credit risk control units about the performance of the rating process, areas needing improvement, and the status of efforts to improve previously identified deficiencies.

(4) Internal ratings-based analysis of the credit risk profile shall be an essential part of the management reporting. Reports shall include at least risk profile and the grades of the respective risk parameters by category, migration across grades, comparison of realised default rates with the expected levels of default, loss from default, and conversion factors and the results of the stress-tests made. Reporting frequencies shall depend on the significance, type and the recipient of the information.

Credit Risk Control

Article 125. The credit risk control unit shall be independent from the personnel and management functions responsible for originating or renewing exposures and shall report directly to bank's management body.

(2) The credit risk control unit shall have the following duties:

1. selection, structuring, and implementation of the rating systems and models, and approval of rating models;

2. determining, testing and monitoring of risk categories and groups;

3. production of analyses and reports containing data or summary reports from and for the rating systems;

4. implementing procedures to verify that risk category or rating group are consistently applied across structural units and geographic areas;

5. reviewing and documenting any changes to the rating process, including the reasons for the changes;

6. reviewing periodically the rating criteria to evaluate if they remain predictive of risk, whereas any changes to the rating process, criteria or individual rating parameters shall be documented;

7. ongoing review, alterations to and oversight of models used in the rating process.

(3) Banks using pooled data according to Article 104, paragraphs 9 and 10, may outsource the tasks in relation to the collection and submission of information under paragraph 2, items 2, 3, 6, and 7;

(4) Upon BNB's request, any bank making use of paragraph 3 shall ensure the access to the external information that is necessary for examining compliance with the minimum requirements. The bank shall ensure that on-site examinations by the BNB to the third parties under paragraph 3 are made possible.

Internal Audit

Article 126. The specialised Internal Audit Office shall review at least annually the bank's rating systems, including the operations of the credit function and the estimation of risk parameters and conversion factors.

Chapter Six

CREDIT RISK MITIGATION

Section One

GENERAL PROVISIONS

Scope of Recognition

Article 127. (1) For the purposes of calculation of the risk weighted exposures under the Standardised Approach, or under the Internal Ratings Based Approach, without using own estimates of LGD and conversion factors, banks may report credit risk mitigation where the requirements of this Chapter have been complied with.

(2) No exposure in respect of which credit risk mitigation is obtained shall produce a higher risk weighted exposure amount or expected loss amount than an otherwise identical exposure in respect of which there is no credit risk mitigation.

(3) Where the risk weighted exposure amount under Standardised Approach or Internal Rating Based Approach already takes account of credit protection the calculation of the credit protection shall not be further recognised under this Chapter.

Effectiveness of Credit Risk Mitigation

Article 128. (1) The technique used to provide the credit protection together with the actions and steps taken and procedures and policies implemented by the lending institution shall be such as to result in credit protection arrangements which are legally effective and enforceable in all relevant jurisdictions.

(2) The lending institution shall take all appropriate steps to ensure the effectiveness of the credit protection arrangement and to address related risks.

(3) Banks reporting credit risk mitigation or expected loss shall have in place effective risk management and control procedures for the risks resulting from credit risk mitigation activities.

(4) Where credit risk mitigation or expected loss is reported, banks shall also perform an overall valuation of the credit risk of the underlying exposure.

(5) A bank shall monitor and control, by means of appropriate written rules and procedures, the residual risk from the lower effectiveness than the expected one of the credit risk mitigation techniques used.

(6) In case of repos, the net amount of the exposure shall be considered to be the underlying exposure.

ECAI Ratings Recognition

Article 129. The credit assessments by ECAIs shall be recognised, where the conditions for their application under the Standardised Approach, as provided for in Section Four *Requirements for Recognition of ECAIs and ECA of* Chapter Four *Standardised Approach* of this Part.

Section Two
FUNDED CREDIT PROTECTION

General Provisions

Article 130. (1) In the case of funded credit protection, to be eligible for recognition the assets relied upon shall be sufficiently liquid and their value over time sufficiently stable to provide appropriate certainty as to the credit protection achieved having regard to the approach used to calculate risk weighted exposure amounts and to the degree of recognition allowed under this Section.

(2) In the case of funded credit protection, the lending institution shall have 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 of the obligor — or other credit event set out in the transaction documentation — and, where applicable, of the custodian holding the collateral.

(3) Funded credit protection is recognised only when the requirement for low correlation under Article 138, paragraph 2 is met.

Netting of Balance Sheet Items of a Single Counterparty

Article 131. (1) Loans and deposits under balance sheet items of a single counterparty may be netted out, where the bank and the counterparty have signed a netting agreement.

(2) The netting under paragraph 1 shall apply where the following conditions are in place:

1. it is provided for that in case of default, insolvency, bankruptcy, or other similar events with a party to the contract, one of the parties owes to the other party the net amount of the liability;

2. the bank certifies that the netting agreement is legally effective and enforceable in all relevant jurisdictions, including in the event of the insolvency or bankruptcy of a counterparty;

3. the bank is in a position to establish at any given time the claims and liabilities subject of the netting agreement;

4. the bank shall monitor and control risks related to the termination of the loan collateral; and

5. the bank monitors and controls the exposures under item 3 on net basis.

(3) Netting out under paragraph 1 of balance sheet items shall not be recognised where it is done based on a master netting agreement covering repurchase transactions or capital market driven transactions. In such cases, the provisions of Articles 132 – 134 shall apply.

Master Netting Agreements Covering Repurchase Transactions and Capital Market-Driven Transactions

Article 132. (1) A bank applying the Financial Collateral Comprehensive Method under Article 162, may net positions subject of master netting agreements covering of repurchase transactions and capital market driven transactions where the master netting agreement meets the requirements under Article 133.

(2) In addition to the requirements under Chapter Eight *Counterparty Credit Risk Treatment* and Chapter Nine *Settlement Risk*, the accepted collateral and the securities or commodities received under a master netting agreement shall meet the criteria under Articles 135 – 137.

Minimum Requirements for Master Netting Agreements

Article 133. Master netting agreements under Article 132 shall be recognised for the purposes of credit risk mitigation when they meet all of the following conditions:

1. the agreement is legally effective and enforceable in all relevant jurisdictions, including in the event of the bankruptcy or insolvency of the counterparty;

2. the agreement gives 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. the agreement provides for the netting of gains and losses on transactions closed out under a master agreement so that a single net amount is owed by one party to the other;

4. the bank shall meet the minimum requirements for the recognition of the financial collateral in accordance with Article 138.

Methods for Recognition of Financial Collaterals

Article 134. For the purposes of this Ordinance, a bank may apply a Financial Collateral Simple Method or Financial Collateral Comprehensive Method for credit risk mitigation where financial collateral is used.

Financial Collaterals, Recognition under the Simple Method

Article 135. (1) The financial collateral recognised under the Financial Collateral Simple Method is:

1. cash on deposit with, or equivalent cash instruments held by the bank;
2. debt securities issued by central governments or central banks, which securities have a credit assessment with credit quality step 4 or above assigned by a recognised ECAI;
3. debt securities issued by institutions, which securities have a credit assessment with credit quality step 3 or above assigned by a recognised ECAI;
4. debt securities issued by other entities, which securities have a credit assessment with credit quality step 3 or above assigned by a recognised ECAI;
5. debt securities with short-term credit assessment associated with credit quality step 3 or above assigned by a recognised ECAI;
6. equities or convertible bonds that are included in a main index; and
7. gold.

(2) The debt securities under paragraph 1 item 2 shall include:

1. (amended; Darjaven Vestnik, issue 38 of 2008, effective as of 11 April 2008) debt securities issued by regional governments or local authorities, exposures to which are treated according to the Standardised Approach as exposures to the central government in whose jurisdiction they are established;
2. debt securities issued by international development banks or international organisations to which a 0% risk weight is assigned under the Standardised Approach.

(3) The debt securities issued under paragraph 1 item 3 may include:

1. debt securities issued by regional governments or local authorities, exposures to which are not treated according to the Standardised Approach as exposures to the central government in whose jurisdiction they are established;
2. debt securities issued by the public sector entities which are treated as exposures to institutions in accordance with the Standardised Approach; and
3. debt securities issued by international development banks other than the ones to which a 0% risk weight is assigned under the Standardised Approach.

(4) Debt securities which do not have a credit assessment by an eligible ECAI may be recognised as eligible collateral if they fulfil the following criteria:

1. the debt securities are listed on a recognised exchange;

2. the debt securities qualify as senior debt;

3. the debt securities issues by the issuing institution of the same seniority have a credit assessment associated with credit quality step 3 or above;

4. the bank is able to provide evidence that there is no information to suggest that the issue would be given a credit quality assessment below step 3; and

5. the bank can demonstrate to the BNB that the market liquidity of the instrument is sufficiently high.

(5) In cases where debt securities under paragraph 1, item 2 – 5, have more than two credit assessments by eligible ECAIs, the bank determines the credit assessment according to Article 53, paragraphs 5 – 6.

Recognition of CIU Shares as Eligible Collateral

Article 136. (1) Units in collective investment undertakings shall be recognised as eligible collateral if the following conditions are satisfied:

1. they have a daily public price quote; and

2. the collective investment undertaking invests in instruments as specified in Article 135.

(2) The use by a collective investment undertaking of derivative instruments to hedge investments shall not prevent units in that undertaking from being eligible as collateral under paragraph 1.

(3) (new; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) If the collective investment undertaking is not limited to investing in instruments that are eligible for recognition under Article 135, units may be recognised with the value of the eligible assets as collateral under the assumption that the CIU has invested to the maximum extent allowed under its mandate in non-eligible assets. In cases where non-eligible assets can have a negative value due to liabilities or contingent liabilities resulting from ownership, the credit institution shall calculate the total value of the non-eligible assets and shall reduce the value of the eligible assets by that of the non-eligible assets in case the latter is negative in total.

Financial Collaterals, Recognition under the Comprehensive Method

Article 137. (1) (former wording of Article 137; amended; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) The financial collateral eligible under the Financial Collateral Comprehensive Method shall be:

1. financial collateral under Articles 135 and 136;

2. equities or convertible bonds not included in a main index but traded on a recognised exchange; and

3. units in collective investment undertakings which in addition to the requirement under Article 136, paragraph 1, item 2, may invest in the instruments under item 2.

(2) (new; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) If the collective investment undertaking under paragraph 1, item 3 invests also in instruments that are not eligible for recognition according to paragraph 1, items 1 and 2, units may be recognised with the value of the eligible assets as collateral under the assumption that the CIU has invested to the maximum extent allowed under its mandate in non-eligible assets. In cases where non-eligible assets can have a negative value due to liabilities or contingent liabilities resulting from ownership, the credit institution shall calculate the total value of the non-eligible assets and shall reduce the value of the eligible assets by that of the non-eligible assets in case the latter is negative in total.

Minimum Requirements to Financial Collateral

Article 138. (1) The types of collateral enumerated in Articles 135 – 137 shall be recognised for the purposes of credit risk mitigation, where the following conditions are met: low correlation, legal certainty and operational requirements.

(2) Low correlation exists where:

1. there is no material positive correlation between the credit quality of the obligor and the value of the collateral;

2. the securities are not issued by the obligor, or any entity from the same group, except in the cases of the obligor's own issues of covered bonds meeting the requirements of the Standardised Approach, in which case the securities are accepted as eligible collateral for repurchase transactions, and the requirements under item 1 are complied with.

(3) Legal certainty exists where the bank 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.

(4) Operational requirements are:

1. collateral arrangements shall be properly documented;

2. a bank shall employ documented rules and procedures with regard to the types and amounts of collateral accepted;

3. there is in place a clear and reliable procedure for the timely foreclosure of a collateral and control of the risks arising from the use of collateral, including: risks of failed or reduced credit protection; wrong valuation of collateral; risks associated with the foreclosure/realisation of the collateral; concentration risk arising from the use of collateral; impact on the institution's overall risk profile;

4. a bank shall revalue the collateral marked to market, and with a minimum frequency of once every six months, or more frequently, whenever a significant decrease in its market value has occurred, or is expected;

5. where the collateral is held by a third party – pledgee, banks must take reasonable steps to ensure that the third party segregates the collateral from its own assets in its reporting;

6. where the Simplified Method for credit risk mitigation is applied, the remaining term to maturity of the collateral may not be less than the remaining term to maturity of the exposure it secures.

Other Collateral

Article 139. (1) Cash on deposit with, or equivalent cash instruments pledged under a collateral arrangement with another institution in favour of the lending institution shall be recognised as eligible credit protection, where the following conditions have been met:

1. the borrower's claim against this institution is valid, unconditionally and irrevocably pledged or assigned in favour of the lending institution, and is legally effective and enforceable in all relevant jurisdictions;

2. the pledgee institution has been notified about the institution or assignment of the collateral, whereas as a result of the notification, the pledge is in a position to effect the payments solely to the lending institution or another party nominated by it.

(2) For the purposes of determining the effect of credit collateral, cash on deposit with a pledgee institution shall be treated as a guarantee issued by the same institution in compliance with the provisions of Article 180.

Life Insurance Policies

Article 140. (1) Life insurance policies pledged to the lending institution may be recognised as eligible credit protection, whereas the value of the credit protection recognised shall be the surrender value of the life insurance policy.

(2) The credit protection in the form of a life insurance policy must satisfy the following conditions:

1. (amended; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) the company providing the life insurance is subject to Directive 2002/83/EC and Directive 2001/17/EC of the European Parliament and of the Council or is subject to supervision by a competent authority of a third country which applies supervisory and regulatory arrangements at least equivalent to those applied in the Community;

2. the life insurance policy is pledged or assigned to the lending institution and the arrangement to this effect is legally effective and enforceable in all relevant jurisdictions;

3. the company providing the life insurance is notified of the pledge or assignment and as a result may not cancel the policy nor the payment of amounts payable under the contract without the consent of the lending institution;

4. the declared surrender value of the policy is non-reducible;

5. the lending institution must have the right to cancel the policy and receive the surrender value in a timely way in the event of the default of the borrower;

6. the bank is informed by the policy-holder of any non-payments under the policy;

7. (amended; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) the credit protection must be provided for the maturity of the loan; where this is not possible because the insurance relationship ends before the loan relationship expires, the credit institution must ensure that the amount deriving from the insurance contract serves the credit institution as security until the end of the duration of the credit agreement.

(3) (repealed; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010)

Instruments Repurchased on Request

Article 141. (1) Instruments issued by third party institutions which will be repurchased by that institution on request shall be recognised as eligible credit protection where they meet the following requirements:

1. the issuing institution has a credit assessment associated with credit quality step 1 for exposures to institutions under the Standardised Approach; and

2. the institution can demonstrate to the BNB that the market liquidity of the instrument is sufficiently high.

(2) The instruments under paragraph 1 shall be treated as a guarantee issued by the issuing institution in compliance with the provisions of Article 178, paragraph 3 and Article 179.

(3) The value of the credit protection recognised under paragraph 1 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 instrument valued in the same way as the debt securities under Article 135, paragraph 3.

Section Three

GUARANTEE PROTECTION. CREDIT DERIVATIVES

General Provisions

Article 142. (1) In the case of unfunded credit protection, to be eligible for recognition the party giving the undertaking shall be sufficiently reliable, and the protection agreement legally effective and enforceable in the relevant jurisdictions, to provide appropriate certainty as to the credit protection achieved having regard to the approach used to calculate risk weighted exposure amounts and to the degree of recognition allowed under this Section.

Eligible Protection Provider

Article 143. (1) The following shall be recognised as eligible protection providers:

1. central governments and central banks;
2. regional governments or local authorities;
3. international development banks;
4. international organisations exposures to which a 0% risk weight under the Standardised Approach is assigned;
5. (amended; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) public sector entities;
6. institutions subject to equivalent supervision; and
7. other legal entities, including parent, subsidiary and affiliate corporate entities that:

a) have a credit assessment by a recognised ECAI corresponding to credit quality step 2 or above; or

b) have an internal rating where the credit institution calculates its risk weighted exposures and expected losses under the IRB approach.

(2) The internal rating under paragraph 1, item 7b shall be recognised if the value of the risk parameter PD is equivalent to that associated with credit quality step 2 or above.

Credit Derivatives

Article 144. (1) The following credit derivatives and instruments composed of such credit derivatives or that are economically effectively similar shall be recognised as eligible:

1. credit default swaps;
2. total return swaps; and
3. single- or multiple-name credit linked notes to the extent of their cash funding.

(2) Where a bank has bought credit protection through a total return swap and records the net payments received on the swap as net income, but does not record offsetting deterioration in the value of the asset that is protected, the credit protection shall not be recognised as eligible.

Internal Hedges

Article 143. (1) When a bank conducts an internal hedge, the credit derivatives used shall be recognised as credit protection, when the credit risk in the trading book shall be transferred out to a third party (a recognised credit protection provider).

(2) Where the condition under paragraph 1 for the calculation of risk weighted exposure amounts and expected loss amounts has been complied with, the requirements for protection by guarantees by third parties shall apply.

Requirements Common to the Recognition of Guarantees and Credit Derivatives

Article 146. (1) Guarantees and credit derivatives shall be recognised as collateral where the following conditions are met:

1. the credit protection shall be direct;

2. the extent of the credit protection shall be clearly defined and incontrovertible;

3. the credit protection shall be legally effective and enforceable in all jurisdictions which are relevant at the time of the conclusion of the credit agreement;

4. the credit protection contract shall not contain any clause, the fulfilment of which is outside the direct control of the lender, that:

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

b) would increase the effective cost of protection as a result of deteriorating 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

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

(2) The bank shall provide evidence that:

a) it has systems in place to manage potential concentration of risk arising from the bank's use of guarantees and credit derivatives; and

b) its strategy in respect of its use of credit derivatives and guarantees corresponds to its management of its overall risk profile.

Recognition of Counter-Guarantees

Article 147. (1) Where an exposure is protected by a guarantee which is itself counter-guaranteed, the same may be treated as an exposure to the issuer of the counter-guarantee, if the same is:

1. a central government or central bank;

2. a regional or local government authority, which is treated as a central government in its jurisdiction under the Standardised Approach;

3. (amended; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) an international development bank or an international organisation to which a 0% risk weight is assigned under the Standardised Approach;

4. a public sector entity treated as an institution;

(2) The guarantees shall be recognised provided 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 under Articles 146 and 148, except for the requirement under Article 146, paragraph 1, item 1; and

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.

Additional Requirements for Recognition of Guarantees

Article 148. (1) The guarantees under Article 146, paragraph 1 and Article 147, paragraph 1 shall meet the following requirements:

1. in the event of default by the client, the lending institution shall have the right to pursue, in a timely manner, the guarantor for any monies due under the claim in respect of which the protection is provided, irrespective if a claim has been filed against the obligor;

2. the guarantee shall be an explicitly documented obligation assumed by the guarantor; and

3. the guarantee shall cover all types of payments the obligor is expected to make in respect of the claim; where certain types of payment are excluded from the guarantee, its value shall be adjusted to reflect the limited coverage.

(2) In the case of guarantees provided in the context of mutual guarantee schemes approved by the BNB, or counter-guarantees issued by the entities under Article 147, paragraph 1, the requirements under paragraph 1, item 1 shall be considered to be satisfied where either of the following conditions are met:

1. the lending bank has the right to obtain, within an established time limit, a payment by the guarantor proportional to the guarantee coverage calculated to represent a robust estimate of the amount of the economic loss, which the lending credit institution would suffer; or

2. the lending bank may demonstrate to the BNB that the economic loss is covered by the guarantee provided.

(3) Economic loss under paragraph 2 shall mean the loss incurred as a result of the borrower's default on any payments, including any interest or any other types of payments.

Additional Requirements for Recognition of Credit Derivatives

Article 149. (1) Credit derivatives under Article 144, paragraph 1 shall be recognised where the following additional conditions under paragraphs 2 – 6 are also be met:

(2) The credit events specified under the credit derivative shall include:

1. the failure to pay the amounts due under the terms of the underlying obligation whereas the grace period of the derivative is the same or shorter than the one of the underlying obligation;

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

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

(3) Where the condition under paragraph 2, item 3 has not been met, the credit coverage may be recognised subject to a reduction in the recognised value as specified under Article 178, paragraph 1;

(4) The occurrence of a credit event shall be ascertained by the persons explicitly provided for in the collateral arrangement, whereas at least one of these should not be the credit protection provider. The credit protection buyer shall have the right and ability to notify the provider about the occurrence of a credit event.

(5) In the case of credit derivatives allowing for cash settlement, a robust valuation process shall be in place in order to estimate loss reliably. There shall be a clearly specified period for obtaining post-credit-event valuations of the underlying obligation.

(6) Where the settlement of a credit derivative entails the transfer of the underlying obligation from the recipient to the protection provider, the terms of the underlying obligation shall not interfere with its timely transfer.

Mismatch between the Underlying Obligation and the Reference Obligation under a Credit Derivative

Article 150. (1) A mismatch between the underlying obligation and the reference obligation under the credit derivative (i.e. the obligation used for the purposes of determining cash settlement value or the deliverable obligation) shall be permissible only if the following conditions are met:

1. the reference obligation ranks pari passu with or is junior to the underlying obligation; and

2. the underlying obligation and the reference obligation share the same issuer/obligor, and there are in place legally enforceable cross-default or cross-acceleration clauses.

Requirements to Credit Protection Providers to Qualify for the Treatment under Article 63, paragraph 5 of Chapter Five "Calculation of the Capital Requirements for Credit Risk under Internal Rating Based Approach"

Article 151. For credit protection deriving from a guarantee or credit derivative, the following conditions shall be met:

1. the underlying obligation shall be:

a) an exposure to a corporates, except for insurance and reinsurance undertakings;

b) exposures to a regional or local government authority or a public sector entities which are not treated as an exposure to a central government or a central bank according to Chapter Five *Calculation of Credit Risk Capital Requirements by the Use of Internal Models*; or

c) an exposure to a small or medium sized entity, classified as a retail exposure according to Chapter Five *Calculation of Credit Risk Capital Requirements by the Use of Internal Models*;

2. the underlying obligors shall not be members of the same group as the protection;

3. the exposure shall be hedged by one of the following instruments:

a) single-name unfunded credit derivatives or single-name guarantees;

b) first-to-default basket derivatives – the treatment shall be applied to the asset within the basket with the lowest risk weighted exposure amount;

c) n^{th}-to-default basket derivatives – the protection obtained is only eligible for consideration under this framework if eligible $(n-1)^{th}$ default protection has also be obtained or where (n-1) of the assets within the basket has/have already defaulted; where this is the case the treatment shall be applied to the asset within the basket with the lowest risk weighted exposure amount;

4. the credit protection meets the requirements set out in Articles 146 and 148 – 150;

5. the risk weight that is associated with the exposure prior to the application of the treatment does not already factor in any aspect of the credit protection;

6. a bank shall have the right and expectation to receive payment from the protection provider without having to take legal action in order to pursue the counterparty for payment, while taking steps, to the extent possible, to satisfy itself as to the protection provider's willingness to pay promptly should a credit event occur;

7. the credit protection shall provide full coverage of all credit losses incurred on the hedged portion of an exposure that arise due to the occurrence of credit events outlined in the contract;

8. there shall be legal certainty with respect to the transferability of a loan, bond, or contingent liability; where a bank intends to deliver an obligation other than the underlying exposure, it shall ensure that the deliverable obligation is sufficiently liquid so that the bank would have the ability to purchase it;

9. the terms and conditions of credit protection arrangements shall be legally confirmed in writing by both the protection provider and the recipient;

10. a bank shall have procedures in place to detect excessive correlation between the creditworthiness of a protection provider and the obligor of the underlying exposure due to their performance being dependent on common factors beyond the systematic risk factor;

11. in the case of protection against dilution risk, the seller of purchased receivables shall not be a member of the same group as the protection provider.

Section Four

ADDITIONAL ELIGIBLE COLLATERALS AND CREDIT PROTECTION PROVIDERS UNDER IRB

General Provisions

Article 152. Where a bank calculates its risk weighted exposures and expected losses under the IRB approach, in addition to the collateral under Articles 138 – 141 and the guarantees issue by the entities under Article 143, the ones provided for in Articles 153 and 155 shall also be recognised.

Real Estate Collateral

Article 153. (1) Residential real estate property which is or will be occupied or let by the owner with the same purpose, subject to the requirement set out in Article 154, paragraphs 1 – 4, may be recognised as eligible collateral where the following conditions are met:

1. the value of the property does not materially depend upon the credit quality of the obligor, including where purely macro-economic factors affect both the value of the property and the performance of the borrower; and

2. the risk of the borrower does not materially depend upon the performance of the underlying property or project, but rather on the underlying capacity of the borrower to repay the debt from other sources; the repayment of the facility does not materially depend on any cash flow generated by the underlying property serving as collateral.

(2) LGD for exposures collateralised by real estate under paragraph 1 is determined according to Section Nine *Calculation of LGD for Additional Eligible Collaterals under IRB*.

Conditions for Recognition of Real Estate

Article 154. (1) For the recognition of a real estate as collateral under Article 153, the following conditions shall be met:

1. the bank has explicitly set forth in its lending rules the types of housing real estate that are eligible as collateral;

2. the bank shall have procedures to monitor that the property taken as protection is adequately insured against damage;

3. the mortgage or charge shall be enforceable in all relevant jurisdictions, and shall be properly filed on a timely basis, and the value of the protection shall be realisable within a reasonable timeframe;

4. the bank shall monitor on a periodic basis the client's compliance with the terms and conditions of the credit and collateral arrangements, and with any other legal provisions.

(2) The bank shall compare the value of the property with the market prices at a minimum once every year or on more frequent basis where the market is subject to significant changes in conditions. If required, the bank shall make revaluations.

(3) When information indicates that the value of the property may have declined materially, the property valuation shall be reviewed by an independent valuer relative.

(4) For loans exceeding BGN 1.5 million or 5% of the own funds of the bank, the property valuation shall be reviewed by an independent valuer at least every two years.

(5) The value of the collateral shall be the market value of the property subject to compliance with the following requirements:

1. the way of determining the market value shall be clearly documented;
2. the market value shall take into account the existence of any speculative elements;
3. the market value shall take into account the existence of any other encumbrances on the property.

Recognition of Collateral under Leasing Contracts

Article 155. Transactions whereby a bank leases property directly or through a company under its control, the property shall be treated the same as loans collateralised by the type of property leased, where the following conditions shall be met:

1. the applicable conditions set out in Article 154 shall be met;
2. there shall be robust risk management on the part of the lessor with respect to the use to which the leased property is put, and its amortisation;
3. there shall be in place a robust legal framework establishing the lessor's legal ownership of the asset and its ability to exercise its rights as owner;
4. the value of the property shall exceed the unamortised portion of the lease.

Protection Providers

Article 156. Institutions, insurance, reinsurance undertakings and export insurance agencies shall be recognised as eligible providers of credit protection, where the following conditions are met:

1. the provider has sufficient professional experience in providing credit protection;
2. the provider is subject to prudential requirements equivalent to those applied under this Ordinance, or as of the time of provision of the credit protection it had an assessment equivalent to credit quality step 3 or above assigned by a recognised ECAI in accordance with the Standardised Approach;
3. as of the time of provision of the credit protection or later on, the provided was assigned an internal rating corresponding to PD equal or lower that the one equivalent to credit quality step 2 under the Standardised Approach;

4. the provided has a current internal rating assigned to it, corresponding to PD equal or lower that the one equivalent to credit quality step 3 under the Standardised Approach;

5. where the credit protection provider is an export insurance agency, the counter-guarantees issued by the government shall not be recognised.

Section Five
CALCULATION OF THE ADJUSTED VALUE OF AN EXPOSURE

General Provisions

Article 157. (1) For the purposes of calculating the effect of applying credit protection, a bank shall use one of the following approaches:

1. Financial Collateral Simple Method;
2. Financial Collateral Comprehensive Method.

(2) (amended; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) The Simple Method may be used only by a bank implementing the Standardised Approach to credit risk.

(3) The Comprehensive Method may be used only by banks implementing the Standardised Approach, or implementing the IRB approach without calculating their own conversion factors.

(4) (amended; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) The simultaneous use of the Comprehensive and Simple methods is permitted only for the purposes of Article 58, paragraphs 1 to 4 and Article 62, paragraph 1 as the credit institution may demonstrate to the BNB that this exceptional application of both methods is not used selectively with the purpose of achieving reduced minimum capital requirements and does not lead to regulatory arbitrage.

Specific Treatment

Article 158. (1) Cash, securities or commodities purchased, borrowed or received under a repurchase transaction or securities or commodities lending or borrowing transaction shall be treated as collateral.

(2) The debt securities meeting the requirements for credit derivatives under Articles 146 – 150 linked to loans extended by the lending institution shall be recognised as cash collateral under Article 135.

(3) In case of on-balance sheet netting of loans and deposits, the lending institution shall treat them as cash collateral.

Basic Calculation Procedure
under the Financial Collateral Simple Method

Article 159. (1) (amended; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) Under the Financial Collateral Simple Method, banks use the risk weights indicated under paragraph 2 of this Article and of Articles 160 – 161 whereas the value of the recognised collateral shall be its market value. For this purpose, the recognition of the collateral is made before applying the conversion factors.

(2) A risk weight corresponding to the collateral under the Standardised Approach shall be applied to the portion of an exposure collateralised by a financial collateral shall be a minimum of 20% except as specified in Articles 160 – 161.

(3) A risk weight corresponding to the borrower's uncollateralised portion shall be applied to an uncollateralised exposure to the borrower.

Calculation Procedure for Repurchase Transactions or Transactions
Involving Lending/Borrowing of Securities under the Simple Method

Article 160. (1) A risk weight 0% shall be assigned to the collateralised portion of an exposure resulting from repurchase transactions or transactions involving lending/borrowing of securities meeting the criteria under Article 170.

(2) Where the counterparty to a transaction is not a core market participant, a risk weight of 10% shall be assigned.

Calculation Procedure for Transactions with OTC Derivatives and
Other Transactions

Article 161. (1) A 0% risk weight shall be assigned to the collateralised portion of the value of OTC derivatives for which the following requirements are met:

1. they are marked to market on a daily basis;
2. the collateral is cash on deposit or a similar instrument;
3. the collateral and the derivative are denominated in the same currency;

(2) A 10% risk weight shall be assigned to the collateralised portion of OTC derivatives, subject to paragraph 1, items 1 and 3, collateralised by debt instruments issued by:

1. central governments or central banks eligible for a 0% risk weight under the Standardised Approach;
2. regional governments or local authorities treated as equal to the issuers under item 1;
3. international development banks or international organisations to which a 0% risk.

(3) A 0% risk weight shall be assigned to instruments where the collateral is denominated in the same currency, and either of the conditions below has been met:

a) the collateral is cash on deposit or a cash assimilated instrument; or

b) the collateral is in the form of debt securities under paragraph 2, and its market value has been discounted by 20%.

Basic Calculation Procedures under the Financial Collateral Comprehensive Method

Article 162. (1) (amended; Darjaven Vestnik, issue 38 of 2008, effective as of 11 April 2008) Under the Financial Collateral Comprehensive Method, independent from the approach chosen for credit risk, the bank takes into account the volatility of the market values of the exposures and collateral through using supervisory or own haircuts.

(2) A bank that uses the own estimates approach must do so for the full range of exposures to credit risk, excluding exposures constituting immaterial portfolios.

(3) Where the collateral consists of several recognised items, the volatility adjustment shall be calculated according to Formula 1 of Appendix 5 *Credit Risk Mitigation*.

(4) (amended; Darjaven Vestnik, issue 38 of 2008, effective as of 11 April 2008) Where the collateral is denominated in a currency that differs from that in which the underlying exposure is denominated, an adjustment reflecting currency volatility shall be added to the volatility adjustment under paragraph 1.

(5) In the cases under paragraph 4, where the exposure is in the form of OTC derivatives transactions covered by netting agreements approved by the BNB, a single volatility adjustment reflecting currency volatility shall be applied. Such a treatment shall be applied irrespective of the number of currencies under the transactions covered by the netting agreement.

Supervisory Volatility Adjustments under the Comprehensive Method

Article 163. When applying the Supervisory volatility adjustments approach, the factors to be used by a bank doing daily revaluation for the volatility adjustments shall be those set out in Tables 1 to 4 of Appendix 5 *Credit Risk Mitigation*. Where there are credit assessments from more than one ECAIs, the bank determines the credit assessments to be used under Article 53, paragraphs 5 and 6.

(2) Where a bank doesn't make daily revaluation, the requirements under Article 169 shall be complied with.

(3) When determining the volatility adjustments under paragraph 1, the liquidation periods shall be as follows:

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

2. for securities repurchase transactions and securities lending or borrowing transactions: 5 business days;

3. for other capital market driven transactions: 10 business days.

(4) For exposures in securities or commodities acquired or lent under repurchase transactions or under securities or commodities lending or borrowing transactions

which are not eligible under the provisions of Articles 135 and 136, the volatility adjustment used is the same as for non-main index equities listed on a recognised exchange.

(5) For eligible units in collective investment undertakings the volatility adjustment is the weighted average volatility adjustments that would apply, having regard to the liquidation period of the transaction as specified under Article 163, paragraphs 3 – 6. If the assets in which the undertaking has invested are not known to the bank, the volatility adjustment shall be the highest volatility adjustment that would apply to any of the assets in which the fund has the right to invest.

(6) For unrated debt securities satisfying the eligibility criteria under Article 135, paragraph 4, the volatility adjustments shall be the same as for securities issued by institutions or corporates with an external credit assessment associated with credit quality steps 2 or 3.

Own Estimates of Volatility Adjustments under the Comprehensive Method

Article 164. (1) With the BNB's permission, a bank complying with the qualitative requirements set out in Articles 166 and 167 and the quantitative requirements under Article 168, may use its own volatility estimates for calculating the volatility adjustments to be applied to collateral and exposures.

(2) In the case of debt securities having a credit assessment from a recognised ECAI equivalent to investment grade, the bank may calculate a volatility estimate for each category of security.

(3) In determining relevant categories set out in paragraph 2, bank shall take into account the type of issuer of the security the external credit assessment of the securities, their residual maturity, and their modified duration. Volatility estimates must be representative of the securities included in the category by the bank.

(4) A bank shall calculate volatility adjustments for each individual item for each debt securities exposure outside the ones under paragraph 2 and for other eligible collateral.

(5) In estimating the volatility adjustment of the collateral or foreign exchange mismatch, any correlations between the main exposure, collateral and/or exchange rates shall not be taken into account.

Quantitative Criteria for Own Estimates of Volatility Adjustments

Article 165. (1) In calculating the volatility adjustments, a 99^{th} percentile one-tailed confidence interval shall be used.

(2) Where no daily revaluation of collateral is done, the provisions of Article 169 shall be complied with.

(3) A bank shall update their data sets at least once every three months or more frequently, where this is necessitated by market conditions.

Liquidation Period under the Own Estimates of Volatility Adjustments

Article 166. (1) In determining its own volatility adjustments, a bank shall comply with the requirements as to the liquidation period under Article 163, paragraph 3.

(2) Where a bank determines its own volatility adjustments based on a shorter or longer liquidation period as the one set for in paragraph 1, the scaling up or down to the required liquidation period shall be done in accordance with the Formula 2 of Appendix 5 *Credit Risk Mitigation*.

(3) A bank shall increase the liquidation period as per paragraph 1 where there are in place circumstances suggesting deterioration in the collateral's liquidity.

(4) A bank shall conduct stress tests to identify if historical data may understate potential volatility.

Historical Observation Period
under the Own Estimates of Volatility Adjustments

Article 167. (1) The historical observation period for calculating volatility adjustments shall be a minimum length of one year.

(2) When a bank uses a weighting scheme or other methods for the observation, the effective observation period shall be at least one year, as the weighted average time lag of the individual observations shall not be less than 6 months.

(3) In case of a significant upsurge in price volatility, the BNB may also require a bank to calculate its volatility adjustments using a shorter observation period.

Qualitative Criteria for Own Estimates of Volatility Adjustments

Article 168. (1) A bank shall use the volatility estimates in the day-to-day risk management process of the bank including in relation to its internal exposure limits.

(2) A bank shall have established procedures for monitoring and ensuring compliance with the internal rules and mechanisms for control of the operation of its system for the estimation of volatility adjustments and shall regularly use these adjustments in its risk management process.

(3) The estimation of volatility adjustments shall be subject to independent review within the bank's internal control processes, and a review and validation of the following shall take place at least once a year:

1. the integration of estimated volatility adjustments into daily risk management;
2. any significant changes in the process for the estimation of volatility adjustments;
3. the consistency, timeliness and reliability of data sources used; and
4. the accuracy and appropriateness of the volatility assumptions.

Volatility Adjustments where Daily Revaluation of Collateral Is Not Applicable

Article 169. Where a bank does no daily revaluation of collateral, the supervisory and own volatility adjustments shall be determined in accordance with the Formula 3 of Appendix 5 *Credit Risk Mitigation*.

Conditions for Applying a 0% Volatility Adjustment

Article 170. (1) In relation to exposures under securities lending or borrowing transactions and repurchase transactions, a bank may apply a 0% volatility adjustment, where the conditions under paragraph 4 are complied with.

(2) Where in another Member State applying a 0% volatility adjustment is permitted with regard to repurchase transactions and securities lending or borrowing transactions in government securities issued by that Member State, a bank may apply a 0% volatility adjustment.

(3) Treatment under paragraphs 1 and 2 shall not be permitted where a bank uses internal models as per Article 173 to determine its volatility adjustments.

(4) For the application of a 0% volatility adjustment under paragraph 1, both of the following conditions have to be complied with:

1. both the exposure and the collateral are cash or debt securities issued by central governments or central banks meeting the requirements under Article 135, paragraph 1, item 2 and paragraph 2 and eligible for a 0% risk weight under the Standardised Approach;

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

3. the maturity of the transaction is no more than one day, except if the exposure and the collateral are subject to daily marking-to-market or daily remargining;

4. in case of a failure to remargin, the time between the last marking-to-market and the liquidation of the collateral shall be no more than four business days;

5. the transaction is settled across a settlement system proven for that type of transaction;

6. the counterparty is considered as a “core market participant” by the competent authorities;

7. the documentation covering the agreement is standard market documentation for such type of transactions;

8. the transaction is governed by terms and conditions specifying that if the counterparty fails to satisfy an obligation to deliver cash or securities or to deliver margin or otherwise defaults, then the payment becomes immediately due.

Calculation of Net Adjusted Value of the Exposures

Article 171. (1) Banks adopting the Financial Collateral Comprehensive Method for financial collateral shall calculate the net adjusted value of the exposure under Formula 4 of Appendix 5 *Credit Risk Mitigation*.

(2) Irrespective of credit risk approach applied, for the purposes under paragraph 1 the banks shall use the value of the off-balance sheet items prior to applying conversion factors.

Calculating Risk Weighted Exposure Amounts and Expected Loss Amounts

Article 172. (1) The fully-adjusted exposure value calculated under Article 171, paragraph 1, shall be accepted as the value of the exposure under the Standardised Approach for credit risk.

(2) A bank applying an IRB approach to credit risk without calculating its own estimates for LGD and conversion factors shall calculate the value of the LGD according to Formula 5 of Appendix 5 *Credit Risk Mitigation*.

Basic Calculation Procedures for Master Netting Agreements for Repurchase Transactions and Capital Market Driven Transactions

Article 173. (1) The fully adjusted exposure value of items under master netting agreements for repurchase transactions and capital market driven transactions shall be determined according to Formula 6 of Appendix 5 *Credit Risk Mitigation*.

(2) The net position in each security or commodity subject to a master netting agreement shall be derived as the total value of the delivered securities or commodities less the value of the lent fungible securities or commodities.

(3) The net position in each currency other than the currency of settlement of the master netting agreement shall be derived as the difference between:

1. the value of the delivered securities and the cash received against them; and

2. the value of the borrowed securities and the cash paid/given against them.

(4) The own or supervisory volatility adjustments applied by the bank shall meet the requirements under Articles 165 – 170.

(5) amended; Darjaven Vestnik, issue 38 of 2008, effective as of 11 April 2008) Any maturity mismatch shall be treated in accordance with Section Seven *Maturity Mismatches* IX *Calculation of LGD for Additional Collaterals under Internal Rating Based Approach* of this Chapter.

(6) The adjusted value of an exposure calculated under paragraph 1 shall be accepted as the value of an exposure under the Standardised Approach or the IRB Approach to credit risk.

Using the Internal Models Approach in case of Master Netting Agreements

Article 174. (1) For calculating the fully adjusted exposure value, a bank may apply an internal model, which takes into account correlation effects between security positions subject to the master netting agreement as well as the liquidity of the instruments concerned. The result of using an internal model estimates of the potential change in value of the unsecured exposure amount.

(2) The internal model under paragraph 1 shall be used irrespective of the credit risk model the credit institution has opted for.

(3) After obtaining permission by the BNB, a bank may also use its internal models for margin lending transactions, if the transactions are covered under an eligible bilateral master netting agreement.

(4) A bank shall use this approach for all counterparties and securities, excluding immaterial portfolios where it may use the Supervisory Volatility Adjustments Approach or the Own Estimates Volatility Adjustments Approach to which Chapter Eight *Counterparty Credit Risk Treatment* is applied.

(5) The internal models approach is available to bank that have received recognition for an internal model for market risk.

Using the Internal Models Approach for Master Netting Agreements from Banks without Approved Models for Market Risk

Article 175. (1) After obtaining permission by the BNB, a bank which does not use an internal market risk measurement model approved by the BNB may apply an internal risk measurement model under Article 174, paragraph 1 where the following requirements have bee met:

1. the bank has implemented a comprehensive and reliable risk management system for managing the risk from transactions under master netting agreements;

2. the internal risk measurement model of the bank is closely integrated into the daily risk management process of the bank and covers a sufficient number of risk factors for measuring the material price-related risks;

3. the bank has a risk control unit that:

a) is independent from business trading units;

b) has available staff suitably skilled in the use of sophisticated risk management models;

c) is responsible for designing and implementing the risk management system;

d) produces daily reports and analyses on the output of the risk measurement model and on the appropriate measures to be taken in terms of position limits;

e) submits the reports produced for review by the competent level of management with sufficient authority to enforce reductions of positions taken and of overall risk exposure.

4. the bank has a proven track record of reasonable accuracy in measuring risks demonstrated through the back-testing of its output using at least one year of data;

5. the bank periodically conducts a rigorous programme of stress testing and the results of these tests are reviewed by senior management and reflected in the risk management policies and limits;

6. the bank has established procedures for monitoring and ensuring compliance with a documented set of internal policies and controls concerning the overall operation of the risk measurement system;

7. the bank's internal audit unit shall conduct an independent review of its risk measurement system covering the activities of the business trading units and of the risk control unit;

8. at least once a year, the bank must conduct a review of its risk management system;

9. the requirements under Article 257, paragraphs 5 and 6 and Article 258 shall be met;

10. the internal model uses appropriate number of risk factors, which covered all material price risks.

(2) Permission under paragraph 1 shall be given in 6 months period after the bank has presented all necessary documents.

Quantitative Criteria for the Internal Models for Master Netting Agreements

Article 176. (1) The calculation of the potential change in value shall be subject to the following minimum standards:

1. at least daily calculation of the potential change in value;

2. a 99th percentile, one-tailed confidence interval is used;

3. the following liquidation periods shall be applied:

a) for securities repurchase transactions and securities lending or borrowing transactions: a 5-business day liquidation period;

b) other capital marked driven transactions: a 10-business day liquidation period.

4. the historical observation period applied for monitoring shall be of at least one year, and in cases of significant upsurge in price volatility – more frequently;

5. the bank shall update its volatility adjustment estimates at least at a three-month interval or more frequency where this is necessitated by the market conditions.

(2) With the BNB's permission, a bank may use empirical correlations within risk categories and across risk categories if the latter can demonstrate that its system for measuring correlations is sound and implemented with integrity.

Exposure Value under the Internal Models for Master Netting Agreements

Article 177. (1) The fully-adjusted exposure value when using internal models shall be derived according to Formula 7 of Appendix 5 *Credit Risk Mitigation*.

(2) Risk weighted exposures shall be calculated based on the data from the previous business day model.

(3) The exposure value under the Standardised Approach or Internal Rating Based Approach for credit risk is equal to the exposure adjusted value under paragraph 1.

Life Insurance Policies Treatment

Article 177a. (new; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) (1) Where the conditions set out in Article 140 are satisfied, the portion of the exposure collateralised by the life insurance policy shall be assigned:

1. where the Standardised Approach for credit risk is applied, the risk weight, as follows:

a) 20%, where the senior unsecured exposure to the company providing the life insurance is assigned a risk weight of 20%;

b) 35%, where the senior unsecured exposure to the company providing the life insurance is assigned a risk weight of 50%;

c) 70%, where the senior unsecured exposure to the company providing the life insurance is assigned a risk weight of 100%;

d) 150%, where the senior unsecured exposure to the company providing the life insurance is assigned a risk weight of 150%;

2. where the Internal Rating Based Approach for credit risk is applied – 40% LGD is assigned but without using credit institution's own estimates for this parameter.

(2) In case of currency mismatch, the current surrender value shall be reduced according to Article 178, paragraph 3, with the value of the credit protection being the current surrender value of the life insurance policy.

Section Six

CALCULATION PROCEDURES UNDER GUARANTEE PROTECTION

General Provisions

Article 178. (1) The value of unfunded credit protection shall be the amount that the protection provider has undertaken to pay in the event of the default of the borrower or on the occurrence of other specified credit events.

(2) 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 credit protection value shall be reduced as follows:

1. where the amount that the protection provider has undertaken to pay is not higher than the exposure value, the value of the credit protection shall be reduced by 40%; or

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 be no higher than 60% of the exposure value.

(3) In case of a currency mismatch between the exposure and the collateral, the value of the credit protection shall be derived at in accordance with Formula 8 of Appendix 5 *Credit Risk Mitigation*.

Treatment as Securitisation Scheme

Article 179. (1) Where the bank transfers to a protection provider a part of the risk of a loan in one or more tranches, the provisions of Chapter Seven *Securitisation Framework* shall apply.

(2) Materiality thresholds on payments below which no payment shall be made in the event of loss are considered to be equivalent to retained first loss positions.

Risk Weighted Amount

Article 180. (1) A bank applying a Standardised Approach shall weigh exposures as follows:

1. the risk weight to be assigned to an exposure which is fully protected by unfunded protection shall be the risk weight of exposures to the protection provider further adjusted for any maturity mismatch;

2. the unprotected portion of the exposure value shall be weighted with the debtor's risk weight;

3. for partially protected exposures, for which the protected and unprotected parts are of equal seniority, the bank shall set calculate the risk weighted amount of the exposure in accordance with Formula 9 of Appendix 5 *Credit Risk Mitigation*.

(2) A bank applying an IRB approach shall weigh its exposures as follows:

1. for the covered portion of the exposure, the PD of the protection provider, or another PD value, where full substitution is deemed not to be warranted. In determining the covered portion amount, the currency and maturity mismatch adjustment shall be taken into account;

2. the portion of a subordinated exposure covered by senior protection may be assigned an LGD assessment corresponding to senior exposures;

3. for any uncovered portion of the exposure the PD and LGD assigned shall be those of the underlying exposure.

(3) (new; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) Under the treatment set out in paragraphs 1 and 2, the conversion factors of off-balance sheet items shall be applied after the weighting of the exposures.

(4) (former paragraph 3; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) In case of partial guarantee where the covered and uncovered portion are with different seniority, the treatment set out in Article 179 shall apply.

Section Seven
MATURITY MISMATCHES

Definition and Recognition of Credit Protection under a Maturity Mismatch

Article 181. (1) A maturity mismatch occurs when the residual maturity of the credit protection is less than that of the protected exposure.

(2) Where there is a maturity mismatch the credit protection shall not be recognised where:

1. the original maturity of the protection is less than 1 year;

2. the exposure is the result of transactions under Article 77, paragraph 6; or

3. (amended; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) the residual term of the protection is below 3 months.

Definition of Maturity

Article 182. (1) For the purposes of this Section, the effective maturity of the underlying exposure shall be the longest possible time, as specified in the agreement, within which the obligor is to fulfil its obligations in full but not exceeding 5 years.

(2) The maturity of the credit protection shall be:

1. where the protection provider is entitled to unilaterally terminate the protection – the time to the earliest date at which the termination entitlement may be exercised;

2. where the bank has the option, at its own discretion, to terminate the protection prior to the agreed time, and this has been provided for in the contractual conditions of the transaction – the time to the earliest date at which that option may be exercised;

3. in all other cases – the time to the earliest date at which that option may be exercised, it the same expires.

(3) Where a credit derivative protection may be terminated prior to expiration of any grace period, upon the expiry of which the default is recognised as having occurred, the maturity of the protection shall be reduced by the grace period.

Valuation of Protection

Article 183. (1) Where the Financial Collateral Simple Method is applied, no protection is recognised for transactions subject to funded credit protection where there is a mismatch between the maturity of the exposure and the maturity of the protection.

(2) Where the Financial Collateral Comprehensive Method is applied for transactions subject to funded credit protection, the maturity of the credit protection and that of the exposure must be reflected in the adjusted value of the collateral according to Formula 10 of Appendix 5 *Credit Risk Mitigation*.

(3) For transactions, subject to unfunded credit protection, the maturity of the credit protection and that of the exposure must be reflected in the adjusted value of credit protection according to the Formula 11 of Appendix 5 *Credit Risk Mitigation*.

Combined Protection under the Standardised Approach

Article 184. In the case where a bank applying the Standardised Approach to credit risk uses more than one form of credit risk mitigation covering a single exposure, the bank shall be required to subdivide the exposure into parts covered by each type of credit risk mitigation tool and shall calculate separately the risk weighted exposure amount for each portion, including cases where credit protection provided by a single protection provider has differing maturities.

Section Eight
BASKET CRM TECHNIQUES

First-to-Default Credit Derivatives

Article 185. (1) A protection through a first-to-default credit derivative shall be recognised, and it is assumed in the calculation of the risk weighted exposure amount that only the exposure with the lowest risk weighted equivalent is protected.

(2) The credit protection under paragraph 1 shall be recognised only where its amount is greater or equal to the exposure value under paragraph 1.

n^{th}-to-Default Credit Derivatives

Article 186. (1) Credit protection through an n^{th}-to-default credit derivative shall be recognised only if protection has also been obtained for n-1 defaults or when n-1 defaults have already occurred. In calculating the risk weighted exposure amount, only the exposure with the lowest risk weighted equivalent, which has not been accepted as protected through a derivative with prior-in-sequence default.

(2) The credit protection under paragraph 1 is recognised only when its value is equal to or exceeds the value of the exposure under paragraph 1.

Section Nine
CALCULATION OF LGD FOR ADDITIONAL COLLATERAL UNDER INTERNAL RATING BASED APPROACH

General Provisions

Article 187. (1) Where the ratio of the value of the collateral to the exposure value is below the first required threshold level (the required minimum collateralisation level for the exposure) as per Table 5 of Appendix 5 *Credit Risk Mitigation*, LGD shall be calculated in accordance with the rules for treatment of unprotected exposures under Chapter Five *Calculating Capital Requirements for Credit Risk by Using Internal Models* of this part.

(2) Where the ratio of the value of the collateral to the exposure value exceeds a second, higher threshold level of the required level of collateralisation, LGD shall be that prescribed in Table 5 of Appendix 5 *Credit Risk Mitigation*.

(3) Where the ratio of the value of the collateral to the exposure value falls between the first and the second required threshold level of protection, the exposure shall be divided into:

1. exposure sufficient to achieving the ratio under paragraph 2;
2. residual exposure to be treated under paragraph 1.

(4) (new; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) For the purposes of paragraphs 1 to 3, the recognition of the collateral shall be made before applying conversion factors.

Combined Protection under the Internal Rating Based Approach

Article 188. (1) Where the risk weighted exposures and expected losses are calculated under an IRB approach, and an exposure is protected by a financial collateral and other eligible protection, a bank shall divide the adjusted value of the exposure into parts each covered by only one type of collateral, and the remaining exposure shall be treated as uncollateralised.

(2) The LGD values shall be calculated separately for each part of exposure.

Chapter Seven
SECURITISATION FRAMEWORK

Section One
GENERAL PROVISIONS

Object

Article 189. (1) The bank calculates the risk weighted amount of securitised positions, or securitising positions which a bank has transferred or acquired under traditional or synthetic securitisation schemes.

(2) (amended; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) The risks (including reputational risk which may arise on complex structures or products) arising from securitisation transactions in relation to which the banks are originator, sponsor or investor shall be evaluated and addressed through appropriate policies and procedures, to ensure in particular that the economic substance of the transaction is fully reflected in the risk assessment and management decisions.

(3) A bank using the Standardised Approach to credit risk for the exposure class to which the securitised exposures would be shall calculate the risk weighted exposure amount for a securitisation position in accordance with Articles 200 – 214.

(4) In all other cases, the bank shall calculate the risk weighted exposure amount of securitisation positions in accordance with the provisions of Articles 200 – 201 and 215 – 229.

Scope of Application by the Originator Bank

Article 190. (1) In the case of a traditional securitisation, the originator bank shall exclude the securitised exposures and expected loss corresponding to them (in the cases under the IRB approach) from its calculation of credit risk weighted amounts.

(2) In the case of a synthetic securitisation, the originator bank shall calculate risk weighted exposure, and expected loss (in the cases under the IRB approach) in respect of the securitised exposures in accordance with Article 227.

Basic Calculation Procedures under Securitisation

Article 191. (1) The risk weighted exposure amount of a securitisation positions shall be included in the calculation of the risk weighted amount of exposures to credit risk.

(2) The risk weights assigned to the exposure value of the position shall be determined based on the credit quality of the position.

(3) The credit quality step under paragraph 2 of a position may be determined by reference to an ECAI credit assessment or otherwise, as set out in this Chapter.

(4) Where a bank holds an exposure to different tranches in a securitisation scheme, the exposure to each tranche shall be considered a separate securitisation position.

(5) The providers of credit protection to securitisation positions shall be considered to directly hold exposures in the securitisation.

(6) Securitisation positions shall include exposures to a securitisation arising from interest rate or currency derivative contracts.

(7) Where a securitisation position is subject to credit protection, the risk weights shall be determined in accordance with Chapter Six *Credit Risk Mitigation*, read in conjunction with this Chapter.

Recognition of Assigned Ratings from ECAIs under Securitisation

Article 192. (1) The risk weight assigned to the securitisation positions shall be determined by comparing the credit assessments of an eligible ECAI against the credit quality steps set out in Appendix 6 *Securitisation*.

(2) To be recognised as eligible by the BNB, an ECAI under paragraph 1:

1. shall meet the requirements under Articles 49 – 52;

2. its credit assessment process shall meet the requirements under Section Three *Using External Credit Assessments.*

3. it shall have sufficient experience in the assessment of securitisation schemes;

4. its assessments shall be sufficiently reliable and accepted by market participants.

(3) A bank shall not use selectively the credit assessments by a recognised ECAI for achieving a higher capital requirement;

(4) The BNB shall recognise the ECAIs, recognised within the meaning of paragraph 1 by the supervisors of another Member State.

(5) BNB shall recognise the determination between credit assessments of an eligible ECAI and credit quality steps, made by the competent authorities of a Member State.

(6) (new; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) Where an ECAI is registered as a credit rating agency in accordance with Regulation (EC) No 1060/2009, the requirements of Article 50 shall not be assessed by the BNB.

Revolving Exposures Securitisation

Article 193. (1) Where there is a securitisation of revolving exposures subject to an early amortisation provision, the originator bank shall calculate, in accordance with Articles 209 and 210, an additional risk weighted exposure amount in respect of the risk that the levels of credit risk to which it is exposed may increase following the operation of the early amortisation provision.

(2) Within the meaning of paragraph 1, a "revolving exposure" shall be an exposure whereby customers' outstanding balances are permitted to fluctuate based on their borrowings and repayments, up to an agreed limit.

(3) Within the meaning of paragraph 1, the "early amortisation provision" shall be a clause which requires, on the occurrence of defined events, investors' positions to be redeemed before the originally stated maturity of the securities issued.

Prohibition for Providing Indirect Support

Article 194. (1) (amended; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) An originator bank applying Article 190 or a sponsor bank, or a bank which has sold instruments from its trading book to a securitisation special purpose entity to the effect that it is no longer required to hold own funds for the risks of these instruments shall not provide indirect support to investors with a view to reducing their potential or actual losses.

(2) For the purposes of paragraph 1, implicit support shall mean any form of support not specified in the contractual obligations to the investors or other participants in the securitisation scheme.

(3) Where an originator bank or a sponsor bank fails to comply with the requirement under paragraph 1, it shall allocate capital corresponding to the underlying exposures if they have not been securitised. The banks shall disclose publicly the availability of additional support under the securitisation scheme and the impact thereof on the regulatory capital.

(4) The BNB may impose additional restrictions in the cases where an originator bank or a sponsor bank is found to have violated the requirement under paragraph 1 on more than one occasion.

Retention of Net Economic Interest

Article 194a. (new; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) (1) A credit institution, other than acting as an originator, a sponsor or original lender, shall be exposed to the credit risk of a securitisation position in its trading book or non-trading book only if the originator, sponsor or original lender has explicitly disclosed to the credit institution that it will retain, on an ongoing basis, a material net economic interest which, in any event, shall not be less than 5%.

(2) Net economic interest is measured at the origination and shall be maintained on an ongoing basis. It shall not be subject to any credit risk mitigation or any short positions or any other hedge or sale. The net economic interest shall be determined by the notional value of off-balance sheet items.

(3) The retention requirements shall be applied only once within one and the same securitisation scheme.

(4) Where an EU parent credit institution or an EU financial holding company, or one of its subsidiaries, as an originator or a sponsor, securitises exposures from several credit institutions, investment firms or other financial institutions which are included in the scope of supervision on a consolidated basis, the requirement referred to in paragraph 1 may be satisfied on the consolidated basis. The first sentence shall apply only where credit institutions, investment firms or financial institutions which created the securitised exposures have committed themselves to adhere to the requirements set out in paragraph 13 and deliver, in a timely manner, to the originator or sponsor and to the EU parent credit institution or an EU financial holding company the information needed to satisfy the requirements referred to in paragraph 15.

(5) Paragraph 1 shall not apply where the securitised exposures are claims or contingent claims or fully, unconditionally and irrevocably guaranteed by:

1. central governments and central banks;

2. regional governments, local authorities and public sector entities of Member States;

3. institutions to which a 50% risk weight or less is assigned under Standardised Approach for credit risk;

4. multilateral development banks.

(6) Paragraph 1 shall not apply to:

1. transactions based on a clear, transparent and accessible index, where the underlying reference entities are identical to those that make up an index of entities that is widely traded, or are other tradable securities other than securitisation positions;

2. syndicated loans, purchased receivables or credit default swaps where these instruments are not used to package and/or hedge a securitisation that is covered by paragraph 1.

(7) Before investing, and as appropriate thereafter, credit institutions shall be able to demonstrate to the BNB for each of their individual securitisation positions, that they have a comprehensive formal policies and procedures appropriate to their

trading book and non-trading book and commensurate with the risk profile of their investments in securitised positions for analysing and recording:

1. information disclosed under paragraph 1, by originators or sponsors to specify the net economic interest that they maintain, on an ongoing basis, in the securitisation scheme;

2. the risk characteristics of the individual securitisation positions;

3. the risk characteristics of the exposures underlying the securitisation position;

4. the reputation and loss experience in earlier securitisations of the originators or sponsors in the relevant exposure classes underlying the securitisation position;

5. the statements and disclosures made by the originators or sponsors, or their agents or advisors, about their due diligence on the securitised exposures and, where applicable, on the quality of the collateral supporting the securitised exposures;

6. where applicable, the methodologies and concepts on which the valuation of collateral supporting the securitised exposures is based and the policies adopted by the originator or sponsor to ensure the independence of the valuer;

7. all the structural features of the securitisation that can materially impact the performance of the credit institution's securitisation position.

(8) Credit institutions shall regularly perform stress tests appropriate to their securitisation positions. To this end, credit institutions may rely on financial models developed by the ECAI provided that credit institutions can demonstrate, when requested, that they took due care prior to investing to validate the relevant assumptions in and structuring of the models and to understand methodology, assumptions and results.

(9) Credit institutions, other that when acting as originators or sponsors or original lenders, shall establish written procedures appropriate to their trading book and non-trading book and commensurate with the risk profile of their investments in securitised positions to monitor on an ongoing basis and in a timely manner performance information on the exposures underlying their securitisation positions. Where relevant, the monitoring shall include:

1. the exposure type;

2. the percentage of loans more than 30, 60 and 90 days past due;

3. default rates;

4. prepayment rates;

5. loans in foreclosure;

6. the collateral type and in case of real estate – occupancy;

7. distribution of credit scores or other measures of credit quality across underlying exposures;

8. industry and geographical diversification;

9. distribution of loan to value ratios with band widths that facilitate adequate sensitivity analysis.

(10) Where the underlying exposures are themselves securitisation positions, credit institutions shall have the information set out in paragraph 9 not only on the

underlying securitisation tranches, such as the issuer name and credit quality, but also on the characteristics and performance of the pools underlying those securitisation tranches.

(11) Credit institutions shall have a thorough understanding of all structural features of a securitisation transaction that would materially impact the performance of their exposures to the transaction such as the contractual waterfall and waterfall related triggers, credit enhancements, liquidity enhancements, market value triggers, and deal-specific definition of default.

(12) Where the requirements in paragraphs 7 to 11 and paragraph 15 are not met by reason of the negligence or omission of the credit institution, the BNB shall impose a proportionate additional risk weight of no less 250%, but not more unfavourable than in application of own funds deduction, which would apply to the relevant securitisation positions under Section Four *Calculation Procedure*, and shall progressively increase the risk weight with each subsequent infringement.

(13) Sponsor and originator credit institutions shall apply the same sound and well-defined criteria for credit-granting to exposures to be securitised as they apply to exposures to be held on their book. To this end, the same processes for approving and, where relevant, amending, renewing and re-financing credits shall be applied by the originator and sponsor credit institutions. Credit institutions shall also apply the same standards of analysis to participations or underwritings in securitisation issues purchased from third parties whether such participations or underwritings are to be held on their trading or non-trading book.

(14) Where the requirements referred to in the paragraph 13 are not met, Article 195, paragraph 1 shall not be applied by an originator credit institution and that originator credit institution shall not be allowed to exclude the securitised exposures from the calculation of its capital requirements.

(15) Sponsor and originator credit institutions shall disclose to investors the level of their commitment under paragraph 1. Sponsor and originator credit institutions shall ensure that prospective investors have readily available access to all materially relevant data on the credit quality and performance of the individual underlying exposures, cash flows and collateral supporting a securitisation exposure, as well as such information that is necessary to conduct comprehensive and well informed stress tests on the cash flows and collateral values supporting the underlying exposures. For that purpose, materially relevant data shall be determined as of the date of the securitisation and where appropriate due to the nature of the securitisation thereafter.

(16) The Bulgarian National Bank shall disclose annually summary description of the outcome of the supervisory review and description of the measures imposed in cases of non-compliance with this Article, subject to the provisions of the Law on Credit Institutions related to bank and professional secrecy.

Section Two

MINIMUM REQUIREMENTS FOR RECOGNITION OF A SIGNIFICANT TRANSFER OF CREDIT RISK, CALCULATION OF THE AMOUNT OF RISK WEIGHTED ASSETS AND EXPECTED LOSS

General Provisions

Article 195. (1) An originator bank shall apply the treatment under this Chapter where significant credit risk associated with the underlying exposures has been transferred under a securitisation scheme.

(2) Where an originator bank has not transferred a significant portion of credit risk, it shall not apply the treatment under this Chapter.

Risk Transfer under Traditional Securitisation

Article 196. (1) (new; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) The originator credit institution of a traditional securitisation may exclude securitised exposures from the calculation of the risk-weighted exposure amounts and expected loss amounts if either of the following conditions is fulfilled:

1. significant credit risk associated with the securitised exposures is considered to have been transferred to third parties;

2. all securitisation positions under the scope of Article 204, paragraph 1 and column ‘All other’ of Tables 1 and 2 of Appendix 6 which are held by the credit institution in this securitisation are subject to deduction from own funds according to Article 6, paragraph 1, item 7.

(2) (new; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) Significant credit risk shall be considered to have been transferred in the following cases:

1. the risk-weighted exposure amounts of the mezzanine securitisation positions held by the originator credit institution in this securitisation do not exceed 50% of the risk-weighted exposure amounts of all mezzanine securitisation positions existing in this securitisation scheme;

2. where there are no mezzanine securitisation positions in a given securitisation and the originator can demonstrate that the exposure value of the securitisation positions that would be subject to deduction from own funds exceeds a reasoned estimate of the expected loss on the securitised exposures by a substantial margin, the originator credit institution does not hold more than 20% of the exposure values of the securitisation positions that would be subject to deduction from own funds.

(3) (new; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) Significant credit risk is considered to have been transferred if the BNB is satisfied that a credit institution has policies and methodologies in place, ensuring that the possible reduction of capital requirements which the originator achieves by the se-

curitisation is justified by a commensurate transfer of credit risk to third parties. The BNB shall only be satisfied if the originator credit institution can demonstrate that such transfer of credit risk to third parties is also recognised for purposes of the credit institution's internal risk management and its internal capital allocation.

(4) (new; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) The treatment under paragraph 2 is not applied if the BNB decides that the possible reduction in risk weighted exposure amounts which the originator credit institution would achieve by this securitisation is not justified by a commensurate transfer of credit risk to third parties.

(5) (former wording of Article 196, amended; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) A transfer of significant credit risk under the traditional securitisation shall be recognised where the transfer meets also the following requirements:

1. the securitisation documentation reflects the economic substance of the transaction;

2. (new; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) the bank and its creditors shall not be entitled to a recourse claim with regard to the securitised exposures in case of bankruptcy or receivership of the bank. This circumstance shall have to be supported by the opinion of qualified legal counsel;

3. the securities issued shall not represent payment obligations of the originator bank;

4. the transferee is a securitisation special-purpose entity (SSPE);

5. the originator bank does not maintain direct or indirect control over the transferred underlying exposures. This condition shall be considered as not complied with if the bank has the right to repurchase from the transferee the previously transferred exposures or if it is obligated to re-assume transferred risk; where the originator bank services the exposures, this shall not of itself constitute indirect control of the exposures;

6. where there is a clean-up call option in the agreement, the following conditions shall be satisfied:

a) the clean-up call option is exercisable only at the discretion of the originator bank;

b) the clean-up call option may only be exercised when 90% or more of the original value of the securitised exposures have been amortised;

c) the clean-up call option is not structured as a credit facility or in a way avoiding allocation of losses to positions held by investors.

7. The securitisation documentation does not contain clauses that:

a) other than in the case of early amortisation, require the originator bank to improve the quality of the securitisation exposures by a change in the composition of the underlying exposures or other mechanisms;

b) envisage an increase in the yield payable on securitisation positions in case of deterioration in the credit quality of the underlying exposures.

Risk Transfer under Synthetic Securitisation

Article 197. (1) (new; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) An originator credit institution of a synthetic securitisation may calculate the risk-weighted exposure amount, and, as relevant, expected loss amounts, for the securitised exposures in accordance with Article 227, if either of the following requirements is met:

1. significant credit risk is considered to have been transferred to third parties either through funded or unfunded credit protection;

2. all securitisation positions under the scope of Article 204, paragraph 1 and column ‘All other’ of Tables 1 and 2 of Appendix 6, which are held by the credit institution in this securitisation are subject to deduction from own funds according to Article 6, paragraph 1, item 7.

(2) (former wording of Article 197, amended; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) Transfer of significant credit risk under the synthetic securitisation shall be recognised where the transfer meets the following requirements:

1. (new; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) the requirements of Article 196, paragraph 2 or 3 are met;

2. (former item 1, amended; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) the securitisation documentation reflects the economic substance of the transaction;

3. (former item 2, amended; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) the credit protection provided complies with the requirements under Chapter Six *Credit Risk Mitigation*. Special purpose entities shall not be recognised as eligible unfunded protection providers;

4. (former item 3, amended; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) the instruments used to transfer credit risk do not contain terms or conditions that:

a) impose significant materiality thresholds below which credit protection is deemed not to be triggered if a credit event occurs;

b) allow for the termination of the protection due to deterioration of the credit quality of the underlying exposures;

c) other than in the case of early amortisation provisions, require positions in the securitisation to be improved by the originator bank;

d) increase the banks’ cost of credit protection or the yield payable to holders of positions in the securitisation in response to a deterioration in the credit quality of the underlying pool.

5. (former item 4, amended; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) an opinion is obtained from qualified legal counsel confirming the enforceability of the credit protection in all relevant jurisdictions.

Section Three

USING EXTERNAL CREDIT ASSESSMENTS

Requirements to be Met by Credit Assessments

Article 198. (1) (former Article 198; amended; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) Credit assessments of an eligible ECAI used for the purposes of calculating risk weighted amounts of securitisation positions under Section Four *Calculation Procedures* shall comply with the following conditions:

1. there shall be no mismatch between the types of payments reflected in the credit assessment and the types of payment to which the bank is entitled under the contract giving rise to the securitisation position;

2. the credit assessments shall be announced and made publicly available to the market and included in the ECAI's transition matrix.

3. (new; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) the credit assessment shall not be based or partly based on unfunded support provided by the bank itself.

(2) (new; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) Where the condition under paragraph 1, item 3 is not met, the bank shall consider the relevant position as if it were not rated.

Use of Credit Assessments

Article 199. (1) Where a bank uses credit assessments of one or more eligible ECAIs, in the calculation of risk weighted exposure amounts for securitisation positions, it shall do so consistently throughout the total period of their application.

(2) Where a securitisation position has two credit assessments given by different ECAIs which assign different risk weights, the higher risk weight shall be used.

(3) Where a securitisation position has three or more credit assessments given by different ECAIs which assign different risk weights, the assessments assigning the two lowest risk weights shall be used for risk-weighing purposes, and then the requirement under paragraph 2 shall apply.

(4) In all other cases, the bank shall use credit assessments by a single eligible ECAI to all the tranches in the securitisation scheme.

(5) A credit assessment of a given tranche under traditional securitisation taking into account the availability of credit protection shall be deemed eligible where:

1. the credit protection is provided directly to the SSPE;

2. the protection meets the requirements of Chapter Six *Credit Risk Mitigation*.

(6) (new; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) Credit assessments may be used only if ECAI is committed to make available publicly the explanation how the performance of pool assets affects its credit assessments of the relevant tranche.

Section Four
CALCULATION PROCEDURES

General Provisions

Article 200. (1) For the purposes of Article 202, the risk weighted exposure amount of a securitisation positions shall be calculated by applying to the exposure value of the position the relevant risk weight.

(2) Where the Standardised Approach is used, the amount of a securitisation position shall be its on-balance sheet value;

(3) Where the IRB Approach is used, the amount of a securitisation position shall be the gross on-balance sheet value prior to adjustments.

(4) The amount of the off-balance sheet securitisation positions shall be calculated by multiplying the nominal value by a 100% conversion factor unless otherwise specified in this chapter.

(5) The value of a securitisation position arising from a derivative instrument listed in Appendix 1 *List of Derivatives*, shall be determined in accordance with the methods set forth in Chapter Eight *Treatment of Counterparty Credit Risk*.

(6) Where a securitisation position is subject to funded credit protection, the exposure value of that position may be modified in accordance with the principles under Chapter Six *Credit Risk Mitigation*.

Risk Overlapping in the Underlying Exposures

Article 201. (amended; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) (1) Where a bank has two or more overlapping securitisation positions covering the same risk in the underlying exposures, the bank shall be required, to the extent that they overlap, to include that portion of the position that causes the higher capital requirement. The bank may also recognise such overlap between specific risk capital charges for positions in the trading book and capital charges for positions in the banking book, provided that the bank is able to calculate and compare the capital charges for the relevant positions.

(2) Where Article 198, paragraph 2 applies to positions in the ABCP, the bank may, subject to the approval of the Bulgarian National Bank, use the risk-weight assigned to a liquidity facility in order to calculate the risk-weighted exposure amount for the ABCP if the following is met:

1. the liquidity facility ranks *pari passu* with the ABCP so that they form overlapping positions; and

2. 100 % of the ABCP issued under the programme is covered by liquidity facilities.

(3) For the purpose of paragraph 1, ‘overlapping’ shall mean that the positions, wholly or partially, represent an exposure to the same risk such that to the extent of the overlap a single exposure is established.

Calculation of Risk Weighted Exposure Amounts under the Standardised Approach

Article 202. (amended; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) The risk weighted exposure amount of a rated securitisation or re-securitisation position shall be calculated by applying to the exposure value the risk weight associated with the credit quality step according to Table 1of Appendix 6 Securitisation.

Use of the Risk Weighted Amount of the Underlying Exposure

Article 203. An originator bank or a sponsor bank may use the risk weighted amount of the underlying exposures which would be calculated had they not been securitised, when it is lower than the risk weighted amount of the securitisation positions.

Treatment of Unrated Positions under the Standardised Approach

Article 204. (1) Unrated securitisation positions shall be deducted from the capital base.

(2) Where a bank knows the composition of the pool of exposures securitised all time, it may apply paragraph 3 for the calculation of the risk weighted exposure amounts.

(3) (amended; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) To determine the risk weighted amount of positions with no credit assessment assigned a bank may apply the weighted-average risk weight of the underlying exposures multiplied by a concentration ratio. For this purpose, the concentration ratio shall be equal to the ratio of the sum of the nominal amounts of all the tranches to the sum of the nominal amounts of the tranches junior to or pari passu with the tranche held by the bank. The resulting risk weight shall not be higher than 833% or lower than any risk weight applicable to a rated more senior tranche. Where a bank is unable to determine the risk weights that would be applied to the securitised exposures in the manner so described, it shall deduct the positions from the capital base.

Treatment of Securitisation Positions Structured as Second Loss Tranches or Better in ABCP Programmes under the Standardised Approach

Article 205. (1) A bank may apply the highest risk weight applicable to the underlying exposures, but not lower than 100% where the securitisation exposure:

1. is a tranche which is in a second loss position or better in the securitisation scheme and the first loss tranche provides material credit enhancement to the second loss tranche;

2. is with credit assessment of a quality the equivalent of investment grade or better; and

(2) The foregoing paragraph shall apply where a bank does not hold a position in the first loss tranche.

Treatment of Unrated Liquidity Facilities under the Standardised Approach

Article 206. (1) (repealed; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010)

(2) (amended; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) A credit institution shall apply a conversion figure of 50% to the nominal amount of a liquidity facility where the following conditions are met:

1. the liquidity facility documentation shall clearly identify and limit the circumstances under which the facility may be drawn;

2. the facility may not be drawn so as to provide credit support by covering losses already incurred;

3. the liquidity facility shall not be used as an instrument for providing permanent or regular funding for the securitisation;

4. repayment of draws on the facility shall not be subordinated to the claims of investors other than to claims arising in respect of interest rate or currency derivative contracts, fees or other such payments, nor be subject to waiver or deferral;

5. where there are credit enhancements from which the liquidity facility would benefit, it shall not be possible for the facility to be drawn after the credit enhancements are exhausted;

6. the credit facility agreement shall include a provision that:

a) results in an automatic reduction in the amount that can be drawn by the amount of exposures that are in default within the meaning of Article 101; or

b) terminates the facility if the average quality of the underlying exposures falls below investment grade, provided the securitised exposures have credit assessments.

(3) The risk weight to be applied shall be the highest risk weight that would be applied to any of the underlying group of exposures.

Unrated Liquidity Facilities that may be Drawn only in the Event of a General Market Disruption

Article 207. (repealed; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010)

Unrated Cash Advance Facilities

Article 208. A conversion figure of 0% may be applied to the nominal amount of a liquidity facility that is unconditionally cancellable provided that:

1. the conditions set out in Article 206 are met;

2. the repayments of draws on the facility are senior to any other claims on the cash flows arising from the securitised exposures.

Additional Capital Requirements for Securitisations of Revolving Exposures with Early Amortisation Provisions under the Standardised Approach

Article 209. (1) When applying the Standardised Approach against a securitisation scheme with revolving exposures an early amortisation provision, in addition to the risk weighted exposure amounts calculated in respect of its securitisation positions purchased, an originator bank shall calculate an additional risk weighted exposure amount according to the principles under Articles 210 – 213.

(2) The originator bank shall apply the treatment set out in paragraph 1 only to the revolving portion of the securitised exposures.

Calculation of Additional Capital Requirements for Originator's Interest and Investor's Interest

Article 210. (1) A bank shall calculate the risk weighted exposure amount under paragraph 1 of the originator's interest and investors' interest.

(2) The originator's interest under paragraph 1 means the exposure value of that part of the drawn amounts on securitised positions, the proportion of which in relation to the amount of the total amount of draws on securitised positions determines the proportion of the cash flows generated on the securitised exposures which are not available to make payments to investors investing in securitisation positions.

(3) The originator's interest shall be the remaining amount of the drawn securitised exposures net of the initiator's interest under paragraph 2.

(4) The claims resulting from the initiator's interest may not be subordinate to the investors' interest.

(5) The exposure of the originator bank, associated with its rights as the originator, shall not be considered a securitisation position but as a direct pro rata exposure to the purchased portion of the securitisation exposures.

Exemptions from Additional Capital Requirements under Early Amortisation Clause

Article 211. An originator bank shall be exempt from the requirements under Article 209 where:

1. according to the contractual conditions, investors in a securitisation scheme of revolving exposures remain fully exposed to all future draws on the underlying exposures, and the risk on the underlying facilities does not return to the originator bank even in case of events resulting in early amortisation;

2. early amortisation provision is not triggered by events related to the performance of the securitised assets or the originator bank.

Maximum Capital Requirement under Securitisations of Revolving Exposures with Early Amortisation Provisions

Article 212. (1) The sum total of the amount of the risk weighted exposure amounts in respect of its positions in the investors' interest and the risk weighted exposure amounts calculated under Article 209 shall be no greater than the greater of:

1. the risk weighted exposure amounts of the investors' interest; and
2. the risk weighted exposure amounts of the underlying up to the amount of the investors' interest as if they had not been securitised.

(2) (amended; Darjaven Vestnik, issue 38 of 2008; effective as of 11 April 2008) Net gains arising from the capitalisation of future income within the meaning of Article 3, paragraph 7 shall not count in the calculation of the maximum exposure amount as indicated in this Article.

Calculation of Risk Weighted Exposure Amounts under Securitisations of Revolving Exposures with Early Amortisation Provisions

Article 213. (1) The risk weighted exposure amount under Article 209 shall be determined by multiplying the amount of the investors' interest by the product of the appropriate conversion figure as per paragraph 2 and the weighted average risk weight that would apply to the underlying revolving exposures.

(2) The conversion factor applicable to the exposure amount shall be determined based on the average three-month additional spread in accordance with Table 3 of Appendix 6 *Securitisation*.

(3) For the purposes of paragraph 2, early amortisation provision shall be considered to be "controlled" where the following conditions are met:

1. the originator bank has an appropriate capital and liquidity management plan in place to ensure that it has sufficient capital and liquidity available in the event of an early amortisation;
2. throughout the period of amortisation of received interest, principal, expenses and losses uncured and amounts recovered on the underlying exposures there shall be pro-rata sharing between the originator's interest and the investor's interest based on the amounts drawn established at least once a month;
3. the amortisation period is considered sufficient for the repayment or recognition of default of at least 90% of the total interest of the originator bank and the investors at the beginning of the early amortisation period;
4. the individual tranches of early repayment shall not exceed the amortisation payment amounts than in case of implementation of the straight-line amortisation over the period set out in item 3.

(4) In the case of securitisations subject to an early amortisation provision of retail exposures which are uncommitted and unconditionally cancellable without prior notice, where the early amortisation is triggered by the excess spread level falling to

a specified level, banks shall compare the three-month average excess spread level with the excess spread levels at which excess spread is required to be trapped.

(5) The requirement under paragraph 3, item 1 is valid also in case or non-controlled amortisation.

(6) Where the early amortisation provision does not explicitly provide for the level at which the excess spread is set, the same level shall be taken to be 450 basis points higher than the excess spread level at which early amortisation is triggered.

(7) A conversion factor of 90% shall be applied to all securitisation positions subject to an early amortisation provision not dealt with under paragraphs 2 – 5, and to those not subject to an early amortisation provision – a conversion factor of 100% shall be applied.

Recognition of Credit Protection Provided on Securitisation Positions under the Standardised Approach

Article 214. (1) The risk weighted amount of a securitisation position not secured by credit protection may be calculated in accordance with the requirements under Chapter Six *Credit Risk Mitigation*.

(2) Where securitisation positions are netted out against capital base positions, a bank shall report in advance the existence of a credit protection under paragraph 1.

Calculation of Risk Weighted Exposure Amounts under the Internal Ratings Based Approach

Article 215. (1) Where the IRB approach is used, the risk weighted exposure amount of a securitisation positions shall be calculated in accordance with Articles 215 – 229.

(2) For a rated position assigned assessments by a recognised ECAI or a position in respect of which an inferred rating may be used, the Ratings Based Method set out in Article 219 shall be used.

(3) For an unrated position the Supervisory Formula Method under Article 220 shall be used except where the Internal Assessment Approach is used under Article 217.

(4) A bank other than an originator or a sponsor of a securitisation scheme may only use the Supervisory Formula Method under Article 220 with the BNB's approval.

(5) Unrated exposures for which it is impossible to use an inferred rating shall be netted against the equity where:

1. the originator or sponsor bank is unable to calculate K_{irb} and has not obtained approval to use the Internal Assessment Approach for positions in ABCP programmes; or

2. the bank is not a bank under item 1 and has not obtained approval to use the Supervisory Formula Method or the Internal Assessment Approach in case of positions in ABCP programmes.

Use of Inferred Ratings under the Internal Ratings Based Approach

Article 216. A bank shall attribute to an unrated securitisation position a credit assessment attributed to a reference tranche of the same securitisation scheme, when the following minimum operational requirements are satisfied:

1. the reference tranche must be subordinate to the unrated position;
2. the maturity of the reference tranche must be equal to or longer than that of the unrated position;
3. the bank reviews on an ongoing basis the credit rating of the reference tranche and updates it to reflect any changes in it.

The "Internal Assessment Approach" for Positions in ABCP Programmes

Article 217. (1) Subject to the BNB's approval, a bank may attribute to an unrated securitisation position in an ABCP programme an internal credit rating under the following conditions:

1. positions in the commercial paper issued from the ABCP programme are rated positions;
2. (amended; Darjaven Vestnik, issue 38 of 2008; effective as of 11 April 2008) the bank can demonstrate that its internal assessment of the credit quality of the position is in compliance with the available assessment methodology of a given eligible ECAI, for the rating of commercial paper backed by underlying exposures of this type;
3. the ECAIs, the methodology of which is used within the meaning of item 2, have assigned an external credit rating of the commercial paper. Quantitative elements, used in assessing the position to a particular credit quality must be at least as conservative as those used by ECAIs in the credit quality assessment;
4. in developing its internal assessment methodology the bank shall have taken into consideration relevant published ratings methodologies of the ECAIs that have provided own ratings. The considerations under the foregoing sentence shall be documented in detail updated regularly;
5. the bank's internal assessment methodology shall include rating grades that shall correspond to the credit assessments of eligible ECAIs;
6. the internal assessment methodology shall be used by the bank in the internal risk management processes, reporting, management decision making and capital allocation processes;
7. an external or independent internal auditor, ECAI or the bank's internal risk management function shall perform regular reviews of the internal assessment process and the credit quality of the exposures;
8. the bank shall compare its internal ratings with any subsequent developments in the exposures to evaluate the performance of its internal assessment methodology and to make adjustments on a timely basis in case of systemic divergences;

9. the ABCP programme shall incorporate:

a) credit and investment guidelines applicable to the underlying assets, for which the programme administrator is required, upon purchasing of an asset, to consider the type of asset being purchased, the type and monetary value of the exposures arising from the provision of liquidity facilities and credit enhancements, the loss distribution, and the legal and economic isolation of the transferred assets from the entity selling the assets;

b) an analysis of the asset seller's risk profile shall be performed and shall include analysis of past and expected future financial performance, current market position, expected future competitiveness, leverage, cash flow, interest coverage and debt rating;

c) a review of the seller's underwriting standards, servicing capabilities, and collection processes.

10. the established restrictions with regard to the underlying assets shall provide for:

a) exclusion of the purchase of assets that are significantly past due or defaulted;

b) limiting excess concentration to individual obligor or geographic area; and

c) limits the tenor of the assets to be purchased.

11. the ABCP programme shall have collections policies and processes that take into account the operational capability and credit quality of the servicer; the ABCP programme shall provide for mitigation seller/servicer risk;

12. the aggregated estimate of loss on an asset pool that the ABCP programme is considering purchasing must take into account all sources of potential risk, such as credit and dilution risk; if the seller-provided credit enhancement is sized based only on credit-related losses, then a separate reserve shall be established for dilution risk, if dilution risk is material for the particular exposure pool; in sizing the required enhancement level, the program shall review several years of historical information of losses, delinquencies, dilutions, and the turnover rate of the receivables;

13. the ABCP programme shall incorporate specific provisions in case of purchase of exposures in order to mitigate potential credit deterioration of the underlying pool of exposures.

(2) The unrated position shall be assigned by the bank to one of the rating grades as per paragraph 1 and shall be attributed the credit assessments corresponding to these rating grades.

Maximum Risk Weighted Exposure Amounts under the Internal Ratings Based Approach

Article 218. For an originator bank, a sponsor bank, or for other bank which can calculate K_{IRB} the risk weighted exposure amounts calculated in respect of it, may be limited to that which would produce a capital requirement equal to the sum of 12% of the risk weighted exposure amounts of the underlying securitised exposures plus the expected loss amounts of those exposures.

Ratings Based Method

Article 219. (amended, Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) (1) The risk weighted exposure amounts of the securitisation and re-securitisation positions with a credit assessment assigned to them shall be determined by multiplying the exposure amounts by the factors set out in Table 4 of Appendix 6 *Securitisation*, corresponding to the credit quality step of the exposure and multiplying the result by a factor of 1.06.

(2) The risk weights in Column A of Table 4 in Appendix 6 *Securitisation* shall be applied where the securitisation position is nor re-securitisation position, where the effective number of exposures securitised is at least six and where the position is in the most senior tranche of a securitisation.

(3) The risk weights in Column B of Table 4 in Appendix 6 *Securitisation* shall be applied where the securitisation position is not re-securitisation position, where the effective number of exposures securitised is at least six and the position is not in the most senior tranche of a securitisation.

(4) The risk weights in Column C of Table 4 in Appendix 6 *Securitisation* shall be applied where the securitisation position is not a re-securitisation position and the effective number of exposures securitised is less than six.

(5) For re-securitisation positions the weightings in Column D of Table 4 of Appendix 6 *Securitisation* shall be applied unless the re-securitisation position is in the most senior tranche of the se-securitisation and none of the underlying exposures were themselves re-securitisation exposures.

(6) The risk weights in Column E of Table 4 in Appendix 6 *Securitisation* shall be applied for re-securitisation positions, which do not met the conditions in paragraph 5.

(7) When determining whether a tranche is the most senior, it is not required to take into consideration amounts due under interest rate or currency derivative contracts, fees due, or other similar payments.

(8) The effective number of securitised exposures shall be calculated in accordance with Formula 1 of Appendix 6 *Securitisation*, whereas multiple exposures to one obligor shall be treated as a single exposure.

(9) Where a bank has determined the share of the biggest underlying exposure in a portfolio, the number of effective exposures may be calculated according to Formula 2 of Appendix 6 *Securitisation*.

(10) Under the rating based method a credit risk mitigation is accounted for as set out in Article 224.

Supervisory Formula Method

Article 220. (1) (amended; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) Under the Supervisory Formula Method, the risk weight for a securitisation position shall be calculated according to Formula 3 of Appendix 6 *Securiti-*

sation, and the weight thus calculated may not be less than 20% for re-securitisation positions and no less than 7% for all other securitisation positions.

(2) If the exposure value of the largest securitised exposure is not more than 3% of the sum of the total value of the securitised exposures, then, for the purposes of the Supervisory Formula Method, a bank may set LGD = 50% and the effective number of exposures may be calculated in accordance with Formula 2 or Formula 4 of Appendix 6 *Securitisation*.

(3) Where a bank securitises retail exposures, the values of parameters **h** and **v** from Formula 3 of Appendix 6 *Securitisation* may be taken to be 0.

(4) The existence of credit protection, when the Supervisory Formula Method is used, shall be presented as required in Article 223 and Articles 225 – 227.

Liquidity Facilities Treatment under the Internal Ratings Based Approach

Article 221. (1) (amended; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) The value of unrated securitisation positions in the form of certain types of liquidity facilities provided shall be determined in accordance with paragraph 3.

(2) (repealed; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010)

(3) Cash advance facilities shall be assigned a conversion figure of 0% where the criteria under Article 208 are met.

Exceptional Treatment of Cases where K_{irb} cannot be Calculated

Article 222. (1) (amended; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) On an exceptional basis and only subject to the consent of the BNB, a bank may temporarily apply the method under paragraph 2 for determining the risk weighted exposure amounts for an unrated securitisation position in the form of a liquidity facility that meets the conditions set out in Article 206, where it is not economically expedient for the bank to calculate the risk weighted amounts of the securitised exposures prior to securitisation to determine the K_{irb}.

(2) A bank may apply to a securitisation position in the form of a liquidity facility the highest risk weight that would be applied to any of the underlying exposures according to Chapter Four *Standardised Approach*. To determine the risk weighted value of the position a conversion figure, as follows, shall be applied to the nominal amount of the liquidity facility:

1. (amended; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010; repealed; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011)
2. 50% where the facility has an original maturity of one year or less;
3. 100% in all other cases.

Recognition of Credit Risk Mitigation in Respect of Securitisation Positions under the Internal Ratings Based Approach

Article 223. Where the credit protection in the form of collaterals and guarantees, eligible for securitisation positions, meets the requirements under Chapter Six *Credit Risk Mitigation*, its existence may be reported according to Articles 224 – 227 for the calculation of risk weighted exposure amounts under the Standardised Approach.

Internal Ratings Based Method for Credit Risk Mitigation

Article 224. Where the Internal Ratings Based Method is used to calculate the securitisation positions, a bank may modify the exposure value and the risk weighted exposure amount thereof in accordance with the provisions of Chapter Six *Credit Risk Mitigation* for the calculation of risk weighted exposure amounts under the Standardised Approach.

Supervisory Formula Method where Full Credit Protection Available

Article 225. (1) When using the Supervisory Formula Method where the credit protection covers the full amount of the securitisation position, the bank shall determine the “effective risk weight” of the exposure which is equal to the percentage ratio of the risk weighted exposure amount to the exposure value.

(2) In the case of funded credit protection, the risk weighted exposure amount of the securitisation position shall be calculated by multiplying the effective risk weight as per paragraph 1 by the adjusted exposure amount of the position as calculated under Chapter Six *Credit Risk Mitigation*.

(3) In the case of guaranteed credit protection, or if the credit risk mitigation covers the “first loss” or losses on a proportional basis, the risk weighted exposure amount of the securitisation position shall be calculated according to Formula 5 of Appendix 6 *Securitisation*.

Supervisory Formula Method where Partial Protection Available

Article 226. (1) In cases other than the ones covered by Article 225, paragraphs 2 and 3, a bank shall treat the securitisation position as two or more positions as the uncovered by credit protection position is being considered as the position with the lowest credit assessment.

(2) The risk weighted exposure amount for this position is calculated in accordance with Formula 3 of Appendix 6 *Securitisation*, whereas the following conditions shall be satisfied:

1. in the case of funded credit protection, the value of “T” shall be the ratio of the net adjusted exposure amount of the position calculated in accordance with Chapter Six *Credit Risk Mitigation* to the sum of notional amounts of the underlying pool of exposures securitised by the relevant tranche;

2. in the case of guaranteed credit protection, the value of "T" shall be reduced by the ratio of the nominal amount of credit protection adjusted for any mismatch in accordance with Chapter Six *Credit Risk Mitigation* to the sum of the exposure amounts of the securitised exposures. The risk weight of the protection provider shall be applied to that portion of the position not falling within the adjusted value of "T".

Calculation of Risk weighted Exposure Amounts for Exposures Securitised in a Synthetic Securitisation by the Originator Bank

Article 227. (1) In calculating risk weighted exposure amounts for the entire pool of securitised exposures in a synthetic securitisation scheme, the originator bank of a synthetic securitisation shall calculate the risk weighted amount of the securitisation scheme tranches held by it according to Article 228 and Section Four *Calculation Procedures.*

(2) The expected loss amounts in case of synthetic securitisation shall be zero where a bank uses internal credit risk models against the underlying exposures.

Treatment of Maturity Mismatches in Synthetic Securitisations by the Originator Bank

Article 228. (1) (amended; Darjaven Vestnik, issue 102 of 2010, effective as of 1 January 2011) For the purposes of calculating the risk-weighted exposure amount in accordance with Article 227, paragraph 1, the bank shall take into consideration any maturity mismatch between the credit protection provided and the securitised exposures in accordance with paragraphs 2–4.

(2) The maturity of the securitised exposures shall be taken to be the longest maturity of any of those exposures subject to a maximum of five years.

(3) The maturity of a securitisation tranche in the form of credit protection shall be determined in accordance with the provisions of Chapter Six *Credit Risk Mitigation*.

(4) An originator bank shall ignore any maturity mismatch between the securitisation tranche and the underlying pool of exposures for tranches, which are subject to deduction from the capital base. For all other tranches, the maturity mismatch shall be calculated according to Formula 6 of Appendix 6 *Securitisation*.

Additional Capital Requirements for Securitisations of Revolving Exposures with Early Amortisation Provisions under the Internal Ratings Based Approach by the Originator Bank

Article 229. (1) When using internal models for the securitisation of revolving exposures with an early amortisation provision, an originator bank shall calculate an additional capital requirement in the manner set out in Articles 209 – 213 in compliance with the instructions under paragraphs 2 – 4.

(2) The originator's interest shall be the sum of:

1. the exposure value of that notional part of a pool of drawn amounts sold into a securitisation, the proportion of which in relation to the amount of the total pool sold into the structure determines the proportion of the cash flows resulting from the securitised exposures which are not available to make payments to the investors in the securitisation positions; plus

2. the exposure value of that part of the pool of undrawn amounts under the securitisation exposures, the proportion of which to the total amount of such undrawn amounts under the securitisation exposures is the same as the proportion as per item 1.

(3) Investor's interest covers the value of the securitised exposures not falling within paragraph 2.

(4) An originator bank's exposures under paragraph 2 shall be treated as follows:

1. under item 1 as a direct exposure of drawn amounts had they not been securitised;

2. under item 2 as a direct exposure of undrawn amounts had they not been securitised.

Reduction in Risk Weighted Exposure Amounts under the Internal Ratings Based Approach

Article 230. (1) In compliance with Article 72, the amount of securitisation positions to be deducted from the capital base may be reduced by the product between 8.334 and the amount of provisions and value adjustments made by the bank, which decrease the amount of underlying securitised exposures on these tranches.

(2) The risk weighted exposure amount of securitisation positions may be reduced by the product between 8.334 and the amount of any value adjustments made by the bank in respect of those exposures.

(3) The amount of securitisation positions that the bank deducts from the capital base, multiplied by 8.334, shall be taken out of the risk weighted amount of securitisation positions under Articles 203 and 218.

(4) In deducting the securitisation positions from the capital base, the bank may take into consideration the following:

1. the value of positions may be derived from their risk weighted amount taking into account any value adjustments made in accordance with paragraphs 1 and 2.

2. the calculation of the exposure value may reflect eligible credit protection in accordance with Articles 224 – 228;

3. where the bank uses the Supervisory Formula Method to calculate the risk weighted exposure amount and $L < K_{IRBR}$ and $[L+T] > K_{IRBR,}$ the position may be treated as two positions with L equal to K_{IRBR} for the more senior of the positions.

Chapter Eight
TREATMENT OF COUNTERPARTY CREDIT RISK

Section One
GENERAL PROVISIONS

Article 231. (1) Counterparty Credit Risk (CCR) means the risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flows.

(2) Counterparty credit risk arises from exposures due to the following:

1. transactions in derivative instruments;
2. repurchase agreements;
3. securities or commodities lending or borrowing transactions;
4. margin lending transactions;
5. long settlement transactions.

(3) Exposures to counterparty credit risk shall be calculated in weighing credit risk exposures.

Section Two
SPECIFIC RISK REQUIREMENTS FOR COUNTERPARTY CREDIT RISK IN THE TRADING PORTFOLIO

Article 232. (1) For trading portfolio position:

1. exposures to counterparty credit risk where this counterparty is an institution may be given the weights applicable to credit institutions;
2. a bank may not use the Financial Collateral Simple Method for recognition of the effect of financial collateral in calculating counterparty credit risk exposures as per Articles 157 – 161;

(2) In addition to the ones permitted under Chapter Six *Credit Risk Mitigation*, the following may be recognised as eligible collateral of trading portfolio positions for credit counterparty risk purposes:

1. in the case of repurchase transactions and securities or commodities lending or borrowing transactions booked in the trading book, all financial instruments and commodities that are eligible to be included in the trading book;
2. for OTC derivative instruments – commodities that are eligible to be included in the trading book.

(3) For the purposes of calculating volatility adjustments where such financial instruments or commodities which are not eligible under Chapter Six *Credit Risk Mitigation*:

1. where a bank uses the Supervisory Volatility Adjustments Approach under Article 163, these instruments or goods shall be treated in the same way as non-main index equities listed on a recognised exchange;

2. where a bank uses its Own Estimates of Volatility Adjustments Approach as per Article 164, the volatility adjustments shall be calculated separately for each position; where a bank uses an Internal Ratings Based Approach, it may calculate the exposure amount in the same way for its trading portfolio.

(4) Where a credit derivative included in the trading book forms part of an internal hedge and the credit protection is recognised under this ordinance, no counterparty risk arising from the position in the credit derivative shall be reported.

(5) (new; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) Notwithstanding the treatment specified in paragraph 4, a credit institution may consistently include for the purposes of calculating capital requirements for counterparty credit risk all credit derivatives included in the trading book and forming part of internal hedges or purchased as protection against a counterparty credit risk exposure where the credit protection is recognised pursuant to this Ordinance.

(6) (former paragraph 5; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) Where banks calculate their risk weighted assets for counterparty risk in trading book using the Internal Ratings Based Approach referred in Article 63, paragraph 5, the treatment of expected loss amounts shall be the following:

1. value adjustments made in order to include the counterparty's credit quality may be included in the total amount of adjustments in the value and provisions for counterparty risk;

2. following approval of BNB, if the counterparty credit risk is adequately calculated in the valuation of the trading book positions, the expected loss amount for counterparty risk exposure should be zero.

Section Three

CHOICE OF THE METHOD

General Provisions

Article 233. (1) A bank shall determine the exposure value for the contracts listed in Appendix 1 *List of Derivatives*, with one of the following methods:

1. Marking-to-Market;
2. Standardised Method;
3. Internal Models Method.

(2) The combined use of the methods under paragraph 1 shall be permitted within a financial group, but not within a single legal entity, except in the cases where it is done in accordance with Article 246, paragraph 7.

(3) Subject to BNB's approval, the Internal Models Method under this chapter may be used to determine the exposure values under Article 231, paragraph 2, where as if the model is used for any of the transactions under items 2, 3, and 4, it shall be also used for the other transactions under items 2, 3 and 4.

(4) The BNB shall grant the permission under paragraph 3 in 1 year period, where the Internal Models Method has been used for three years, and in the last year

the capital requirements for counterparty credit risk have been use-tested by reporting to the BNB according to this method.

(5) At a bank's discretion, the Internal Models Method shall not be used for exposures which are insignificant in terms of their size and risk involved.

Counterparty Credit Risk Exceptions

Article 234. (1) Counterparty credit risk exposures shall not be reported where a bank has purchased credit derivative protection against a banking book exposure, or against a CCR exposure, and it computes its capital requirement for the hedged asset in accordance with:

1. credit risk mitigation under Articles 178 – 180; or

2. the Internal Ratings Based Approach under Article 63, paragraph 5 or Articles 115 – 117.

(2) The exposure value for CCR shall not be reported where the bank is a provider of a credit default swaps in the banking book and reports credit risk on the full notional amount of the contract.

(3) (new; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) Where a credit institution applies Article 232, paragraph 5, the treatment under paragraph 1 is not applicable.

(4) (new; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) Notwithstanding paragraph 1, a credit institution may choose consistently to include for the purposes of calculating capital 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 recognised pursuant to this Ordinance.

Calculation of the Exposure Value for a Given Counterparty

Article 235. The exposure value to the respective counterparty is equal to the sum of the exposure values calculated for each netting set with that counterparty.

Transactions with Central Counterparty

Article 236. For the transaction under Article 231, paragraph 2, no exposure value for credit risk or for CCR shall be reported if both conditions below have been met:

1. the transactions have been concluded with a central counterparty;

2. the transactions have been confirmed by the counterparty;

3. all the central counterparty's exposures to CCR under all of its commitments are fully secured on a daily basis.

Long Settlement Transaction Treatment

Article 237. (1) Exposures arising from long settlement transactions can be determined using any of the method set out in Article 233, paragraph 1, other than the methods uses for treating the transactions under Article 231, paragraph 2, items 1 – 4.

(2) In calculating capital requirements for long settlement transactions, a bank that uses the Internal Ratings Based Approach may use the risk weights under the Standardised Approach to credit risk provided it applies these for all such transactions.

Section Four
MARK-TO-MARKET METHOD

General Provisions

Article 238. (1) For the purpose of calculating the exposure to counterparty credit risk when using the Mark-to-Market Method, a bank shall calculate the exposure value by adding up the current replacement cost and the potential future credit exposure.

(2) The current replacement cost shall be determining by comparing the marked-to market-value of the contracts with their fixed contract price. Where the market value is positive, the current replacement cost shall be equal to the market value, where the market value is negative, the current replacement cost shall be zero.

(3) The current replacement cost of a set of contracts shall be the sum total of the contracts currently marked-to-market.

(4) The potential future credit exposure shall be obtained by multiplying the notional principal amounts of the contracts by the respective percentages from Table 1 of Appendix 7 *Counterparty Credit Risk*, whereas:

1. in the case of single-currency "floating/floating" interest rate swaps only the current replacement cost will be calculated;

2. in the case of total return swap or a credit default swap, the potential future credit exposure shall be determined by multiplying the nominal amount of the instrument by the following percentages:

a) where the reference obligation is a qualifying item within the meaning of § 1, item 9 of the Additional Provision – 5%;

b) where the reference obligation is not a qualifying item within the meaning of § 1, item 9 of the Additional Provision – 10%.

3. (amended; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) in the case a bank the exposure of which arising from a credit default swap represents a long position in the underlying instrument, may use a 0% risk weight for potential future credit exposure, unless the swap in question is subject to close-out due to the insolvency of the entity the exposure of which arising from the swap

represents a short position in the underlying instrument; even though the underlying instrument has not defaulted, in which case the figure for potential future credit exposure of the bank shall be limited to the amount of premia which are not yet paid by the entity to the bank;

4. where a credit derivative provides protection in relation to "n^{th} to default", the applicable percentage under item 2 shall be determined by the obligation with the n^{th} lowest credit quality.

Availability of Suitable Risk Measure

Article 239. If the Mark-to-Market Method is used and the notional value is not a relevant measurement for the risk inherent in a given contract, the value shall be adjusted in a manner corresponding to the risk profile of the contract.

Section Five
STANDARDISED METHOD

General Provisions

Article 240. The Standardised Method shall be used only for OTC derivatives and long settlement transactions.

(2) The exposure value shall be calculated separately for each netting set in accordance with Formula 1 of Appendix 7 *Counterparty Credit Risk.*

(3) For the calculation under paragraph 2, the collateral under Chapter Six *Credit Risk Mitigation* and Article 232, paragraph 2 shall be recognised. Collateral received from a counterparty shall be included in the calculation with a positive sign, and collateral provided to the counterparty shall be included with a negative sign.

Payment Legs for Transaction with a Linear Risk Profile

Article 241. (1) Where an OTC derivative transaction with a linear risk profile stipulates the exchange of a financial instrument for a payment, the payment part is referred to as the payment leg.

(2) Where a transaction stipulates the exchange of payment against payment consist of two payment legs, which constitute the contractually agreed gross payments. A transaction that consist of two payment legs that are denominated in the same currency shall be treated as a single-leg transaction, the payment leg of which corresponds to the net payment.

(3) For payment legs with a residual term to maturity below one year, a credit institution may report no interest rate risk.

Risk Positions for Transaction with a Linear Risk Profile

Article 242. (1) Transactions with a linear risk profile shall be mapped to constituent positions as follows:

1. where the underlying instruments are equities or equity indices, gold or commodities – to a risk position in the respective equity (including an index), interest rate risk position for the payment leg;

2. where the underlying instrument is a debt instrument – to interest rate risk positions for each of the payment legs;

3. where they involve an exchange of amounts – as interest rate risk positions corresponding to each of the payment legs.

(2) If the payment legs or the debt instruments under paragraph 1 are denominated in a foreign currency, they are mapped to a risk position in the respective currency.

(3) The exposure value in case of an underlying currency swap shall not be reported.

(4) The size of a risk position from a transaction with linear risk profile shall be as follows:

1. where the underlying instrument is not a debt instrument – the effective notional value (market price multiplied by quantity) of the underlying financial instrument or commodity converted into BGN;

2. where the underlying instrument is a debt instrument or a payment leg – the effective notional value of the outstanding gross payments (including the notional amount – principal), converted into BGN, multiplied by the modified duration of the debt instrument or payment leg, respectively;

3. for credit default swap – the referent debt instrument principal, multiplied by the remaining maturity of the swap.

Risk Positions for Transaction with a Non-linear Risk Profile

Article 243. The size of a risk position from an OTC derivative with a non-linear risk profile shall be as follows:

1. where the underlying instrument is not a debt instrument – the delta equivalent of the effective notional value of the underlying financial instrument;

2. where the underlying instrument is a debt instrument or a payment leg – the delta equivalent of the effective notional value of the financial instrument or payment leg multiplied by the respective modified duration.

Size and Sign of Risk Positions

Article 244. A bank may use the following formulae to determine the size and sign of a risk position:

1. for all instruments other than debt instruments – Formula 2 of Appendix 7 *Counterparty Credit Risk*;

2. for debt instruments and payment legs – Formula 3 of Appendix 7 *Counterparty Credit Risk*.

Calculation of Risk Positions for a Hedging Set

Article 245. The risk positions are to be grouped into hedging sets. For each hedging set, the net risk position shall be calculated as the absolute value amount of the sum of the resulting risk positions in the set.

Forming a Hedging Set

Article 246. (1) (amended; Darjaven Vestnik, issue 38 of 2008, effective as of 11 April 2008) For interest rate risk positions from money deposits received from the counterparty as collateral, from payment legs and from underlying debt instruments, to which a capital charge of 1.6% or less applies under Article 276, hedging sets, as set out in Table 3 of Appendix 7 Counterparty Credit Risk, shall be defined for each individual currency based on a combination of the criteria of "residual maturity" and "referenced interest rates".

(2) For interest rate risk positions from underlying debt instruments or payment legs, the remaining maturity is the length of the time interval up to the next readjustment of the interest rate. In all other cases, it is the remaining life of the underlying debt instrument or in the case of a payment leg, the remaining life of the transaction that is used.

(3) (amended; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) For the credit default swaps, one hedging set is defined for each issuer of a reference debt instrument. N^{th}-to- default basket credit default swaps shall be treated as follows:

1. the size of a risk position in a reference debt instrument, a basket underlying an n^{th}- to-default credit default swap, is 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 is one hedging set for each reference debt instrument in a basket underlying a given n^{th}-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 counterparty credit risk multiplier applicable to each hedging set created for one the reference debt instruments of an n^{th}- to-default derivative is:

a) 0.3% for reference debt instruments that have a credit assessment from a recognised ECAI equivalent to credit quality step 3 or more favourable credit quality step;

b) 0.6% for all other debt instruments.

(4) For interest rate risk positions from money deposits that are posted with a counterparty as collateral when that counterparty does not have debt obligations of low specific risk and from underlying debt instruments, to which a capital charge of more than 1.6% applies under Article 276, one hedging set is defined for each issuer/ counterparty. One hedging set may comprise positions in the debt instruments of a specific issuer, including in the cases of reference debt instruments for credit default

swaps, to the same hedging set – of payment legs equal to debt instruments of the same issuer.

(5) Underlying financial instruments other than debt instruments shall be assigned to the same respective hedging sets if they are identical or similar instruments. The following instruments shall be treated as similar:

1. equities of the same issuer. An equity index is treated as a separate issuer;

2. assets of the same precious metal or goods. A precious metal index is treated as a separate precious metal or goods;

3. instruments that constitute electric power delivery rights and obligations that refer to the same peak or off-peak load time interval within any 24-hour interval;

(6) The CCR multipliers as per Formula 1 of Appendix 7 *Counterparty Credit Risk* for the different hedging set categories are set out in Table 5 of Appendix 7 *Counterparty Credit Risk*.

(7) For transactions with a non-linear risk profile or for payment legs and transactions with debt instruments as underlying for which a bank cannot determine the delta or the modified duration, respectively, with an instrument model approved by the BNB for the purposes of determining the minimum capital requirements for market risk, the bank shall use the Mark-to-Market Method.

Preliminary Procedures

Article 247. (1) Prior to including a transaction in a hedging set, a bank shall apply internal verification procedures to check if a transaction is covered by a legally enforceable netting contract that meets the requirements set out in Section Seven *Netting Agreements*.

(2) Prior to recognising the effect of collateral used to mitigate CCR, a bank shall have internal procedures to verify that, the collateral meets the legal certainty standards set out in Chapter Six *Credit Risk Mitigation*.

Section Six
INTERNAL MODEL METHOD

Introduction

Article 248. (1) Subject to the BNB's approval, the Internal Model Method (IMM) can be introduced in for the calculation of capital requirements across different transaction types, whereas the counterparty risk not captured by the model at the respective phase shall be reported through any of the other methods under this Chapter.

(2) For all OTC derivative transactions and for long settlement transactions for which a bank has not received approval to use the IMM, the bank shall use any of the other methods set out in this Section.

(3) Combined use under paragraph 2 is possible within a banking group, and within a legal entity – only in the cases under Article 246, paragraph 7.

(4) Banks which have obtained permission to use the IMM shall not revert to the use of the other methods set out in this Section, except for demonstrated good cause and subject to the BNB's approval.

(5) A bank that has ceased to comply with the requirements in this Section shall either present to the BNB a plan for a timely return to compliance or demonstrate that the effect of non-compliance is immaterial.

Exposure Value

Article 249. (1) For the purposes of this method, the exposure value shall be measured at the level of the netting set. The model shall specify the forecasting distribution for changes in the market value of the netting set attributable to changes in market variables, such as interest rates, foreign exchange rates. The model shall compute the exposure value for the netting set at each future date given the changes in the market variables. For margined counterparties, the model may also capture future collateral movements.

(2) A bank may include eligible financial collateral under Chapter Four *Credit Risk Mitigation* and Article 232, paragraph 2 in their forecasting distributions for changes in the market value of the netting set, if the collateral meets the quantitative, qualitative requirements and the data requirements as per Articles 253 – 257.

(3) The exposure value shall be calculated as the product of a (equal to 1.4) times the Effective EPE.

(4) The Effective EE shall be computed recursively according to Formula 4 of Appendix 7 *Counterparty Credit Risk.*

(5) The Effective EPE is calculated according to Formula 5 of Appendix 7 *Counterparty Credit Risk* as the weighted average of the Effective EE.

(6) The Effective Expected Exposure and the peak exposure measures shall be calculated based on a distribution of exposures that accounts for the possible non-normality of the distribution of exposures.

(7) A bank may calculate the exposure value in a manner other than the one indicated in paragraph 3, provided the obtained value for each counterparty is not less.

Joint Simulation of Market and Credit Risk Factors

Article 250. Where joint simulation of market and credit risk factors, volatilities and correlations of market risk factors shall be conditioned on the credit risk factors to reflect potential increases in volatility or correlation in an economic downturn.

Netting Set Subject to a Margin Agreement

Article 251. If the netting set is subject to a margin agreement, the expected positive exposure shall be one of the following measures:

1. the effective EPE without taking into account the margin agreement;

2. the threshold (if positive) under the margin agreement plus an add-on that reflects the potential increase in exposure over the margin period of risk. This period

shall be deemed to be not less than five business days for a netting set consisting of repo-style transactions subject to daily remargining and daily mark-to-market, and ten business days for all other netting sets;

3. the result of the model for calculation of the expected exposure, if it captures the effect of the margining, and if the BNB's approval under Article 233, paragraph 3 for this purpose has been obtained.

Minimum Requirements for EPE Models

Article 252. A bank's EPE model shall meet the requirements set out in Articles 253 – 257.

Controlling Counterparty Credit Risk

Article 253. (1) A bank shall have a CCR control unit which shall:

1. be responsible for the design and implementation of its CCR management system, including the initial and on-going validation of the model;

2. control input data integrity and produce and analyse reports on the output of the bank's risk measurement model, including an evaluation of the relationship between measures of risk exposure and credit and trading limits;

3. be independent from units responsible for originating, renewing or trading exposures and free from undue influence;

4. be adequately staffed; it shall report directly to the senior management of the bank;

5. be closely integrated into the day-to-day credit risk management processes of planning, monitoring and controlling the bank's credit and overall risk profile.

(2) A bank shall have CCR management policies, processes and systems that are conceptually sound and implemented with integrity. A sound CCR management framework shall include the identification, measurement, management, approval and internal reporting of CCR.

(3) A bank's risk management policies shall take account of market, liquidity, and legal and operational risks that can be associated with CCR. A bank shall not undertake business with a counterparty without assessing its creditworthiness and shall take due account of settlement and pre-settlement credit risk. These risks shall be managed as comprehensively as practicable at the counterparty level and at the firm-wide level.

(4) The competent management bodies shall be actively involved in the CCR control process and shall regard this as an essential aspect of the business to which significant resources need to be devoted. The competent senior management shall be aware of the limitations and assumptions of the model used and the impact these can have on the reliability of the output. Senior management shall also consider the uncertainties of the market environment and operational issues and be aware of how these are reflected in the model.

(5) The daily reports of a bank on its exposures to CCR shall be reviewed by a level of management with sufficient seniority and authority to enforce both reductions of positions taken by individual credit managers or traders and reductions in the bank's overall CCR exposure.

(6) A CCR management system shall be used in conjunction with internal credit and trading limits. These limits shall be related to the bank's risk measurement model in a manner that is consistent over time and that is well understood by credit managers, traders and senior management.

(7) The system for measurement of CCR shall include measuring daily and intraday usage of credit lines. The bank shall measure current exposure gross and net of collateral. A bank shall calculate and monitor peak exposure or a potential future exposure at portfolio and counterparty level at the confidence interval chosen by it, and shall take account of large or concentrated positions, including by groups of related counterparties, by industry, by market, etc.

(8) A bank shall have in place and shall use regularly a comprehensive program of stress testing as a supplement to the CCR analysis based on the day-to-day output of the bank's risk measurement model. The results of this stress testing shall be reviewed periodically by senior management and shall be reflected in the CCR policies and limits set by the respective competent management bodies. Where stress tests reveal particular vulnerability to a given set of circumstances, prompt steps shall be taken to manage those risks appropriately.

(9) A bank shall have a routine procedure in place for ensuring compliance with a documented set of internal policies, controls and procedures concerning the operation of the CCR management system. This system shall be well documented and shall provide an explanation of the empirical techniques used to measure CCR.

(10) A bank's internal audit process shall include an independent review of its CCR management system. This review shall include the activities of the business units referred to in paragraph 1, including the independent CCR control unit. A review of the overall CCR management process shall take place at regular intervals and shall specifically address, at a minimum:

1. the availability of adequate documentation of the CCR management system and process;

2. the organisation of the CCR control unit;

3. the integration of CCR measures into daily risk management;

4. the approval process for risk pricing models and valuation systems used by front and back-office personnel;

5. the manner of validation of any significant change in the CCR measurement process;

6. the scope of CCR captured by the risk measurement model;

7. the integrity of the management information system;

8. the accuracy and completeness of CCR data;

9. the verification of the consistency, timeliness and reliability of data sources used to run models, including the independence of such data sources;

10. the accuracy and appropriateness of volatility and correlation assumptions;

11. the accuracy of valuation, including risk transformation calculations;

12. the verification of back-testing of the model's accuracy.

Criteria for Use of the Model

Article 254. (1) The distribution of exposures generated by the model used to calculate effective EPE shall be closely integrated into the day-to-day CCR management process. The model's output shall accordingly play an essential role in the credit approval, CCR management, internal capital allocation and corporate governance of the bank.

(2) (amended; Darjaven Vestnik, issue 38 of 2008, effective as of 11 April 2008) A bank shall have a track record in the use of models that generate a distribution of exposures to CCR. These data shall demonstrate that the models under Article 233, paragraph 4 meet the minimum requirements under this Chapter.

(3) The model used to generate a distribution of exposures to CCR shall be part of a CCR management framework that includes the identification, measurement, management, approval and internal reporting of this risk. This framework shall include the measurement of usage of credit lines (aggregating CCR exposures with other credit exposures) and internal capital allocation. A bank shall measure and manage current exposure gross and net of collateral. The use test is satisfied if a bank uses other CCR measures, such as peak exposure or potential future exposure, based on the distribution of exposures generated by the same model to compute EPE.

(4) A bank shall have the systems capability to estimate EE daily if necessary, unless it demonstrates to the BNB that its exposures to CCR warrant less frequent calculation. The bank shall compute EE along a time profile of forecasting horizons that adequately reflects the time structure of future cash flows and maturity of the contracts and in a manner that is consistent with the materiality and composition of the exposures.

(5) Exposure shall be measured, monitored and controlled over the life of all contracts in the netting set. The bank shall have procedures in place to identify and control the risks for counterparties where the exposure rises beyond the one-year horizon. The forecast increase in exposure shall be an input into the bank's internal capital model.

Stress Testing

Article 255. A bank shall have in place sound stress testing processes for use in the assessment of capital adequacy for CCR. These stress test outputs shall be compared with the EPE and shall be considered as part of the process required under Article 11, paragraph 2. Stress testing shall also involve identifying possible events or future changes in economic conditions that could have unfavourable effects on a bank's credit exposures and an assessment of the bank's ability to withstand such changes.

(2) The stress testing shall include jointly stressing market and credit risk factors. These tests shall cover concentration risk (to a single counterparty or groups of counterparties), correlation risk across market and credit risk, and the risk that liquidating the counterparty's positions could move the market. Stress tests shall also consider the impact on the bank's own positions of such market moves and integrate that impact in its assessment of CCR.

Wrong-Way Risk

Article 256. (1) A bank shall give due consideration to exposures that give rise to a significant degree of General Wrong-Way Risk.

(2) A bank shall have procedures in place to identify, monitor and control cases of Specific Wrong-Way Risk, beginning at the inception of a transaction and continuing through the life of the transaction to its final settlement.

Integrity of the Modelling Process

Article 257. (1) The EPE evaluation model shall reflect in a timely, complete, and conservative fashion transaction terms and specifications, including contract notional amounts, maturity dates, reference assets, existing netting and margining arrangements whereas:

1. the terms and specifications shall be maintained in a database that is subject to formal and periodic audit;

2. the transmission of transaction terms and specifications data to the model shall also be subject to internal audit. The bank shall have in place a formal reconciliation processes which currently reconciles the model and source data systems to verify that transaction terms and specifications are being reflected in EPE correctly or at least conservatively;

3. the process for recognising netting arrangements shall require signoff by legal staff to verify the legal enforceability of netting and be input into the database by an independent unit.

(2) When using the model, the following requirements to the data used shall be complied with:

1. current exposures shall be calculated based on current market prices;

2. where historical data are used to estimate volatility and correlations, at least three years of historical data shall be used and shall be updated quarterly or more frequently if market conditions warrant. The data shall cover a full range of economic conditions, such as a full business cycle;

3. the prices supplied by various business units shall be validated by an independent unit, and shall be fed into the model in a timely and complete fashion, and maintained in a database subject to formal and periodic audit;

4. a bank shall also have a well-developed data integrity process to clean the data of erroneous and/or anomalous observations;

5. where the model relies on proxy market data, including, for new products, where three years of historical data may not be available, internal policies shall identify suitable proxies and the bank shall demonstrate empirically that the proxy provides a conservative representation of the underlying risk under adverse market conditions;

6. where the model captures the effect of collateral on changes in the market value of the netting set, the bank shall have adequate historical data to model the volatility of the collateral.

(3) The model validation process shall be clearly articulated in banks' policies and procedures, and shall specify the kind of testing needed to ensure model integrity and identify conditions under which assumptions within the model are violated and may result in an understatement of EPE. The validation process shall include a review of the comprehensiveness of the model.

(4) A bank shall monitor the appropriate risks and have processes in place to adjust its estimation of EPE when those risks become significant. This includes the following:

1. identification and management of exposures to specific wrong-way risk;

2. comparison on a regular basis of the estimate of EPE for one year with EPE over the life of the exposure, where for exposure is with a rising risk profile after one year;

3. comparison on a regular basis of the replacement cost (current exposure) and the realised exposure profile for exposures with a residual maturity below one year or storage of data that would allow such a comparison.

(5) Prior to including a transaction in a netting set, a bank shall implement an internal procedure verifying that the transaction is covered by a legally enforceable netting contract as per Section Seven *Netting Agreements*.

(6) A bank that recognises the effect of collateral in its calculations to mitigate its CCR shall have internal procedures to verify that the collateral meets the legal certainty standards set out in Chapter Six *Credit Risk Mitigation*.

Validation of EPE Models

Article 258. (1) A bank's EPE model shall meet the following validation requirements:

1. the qualitative validation requirements set out in Part Three *Market Risks*, Chapter Fifteen *Internal Models*;

2. interest rates, foreign exchange rates, equity prices, commodities, and other market risk factors shall be forecast over long time horizons. The performance of the forecasting model for market risk factors shall be validated over a long time horizon;

3. the pricing models used to calculate CCR exposure for a given scenario of future shocks to market risk factors shall be tested as part of the model validation

process; pricing models for options shall account for the nonlinearity of option value with respect to market risk factors;

4. the EPE model shall capture transaction-specific information concerning the circumstances of each transaction which:

a) justify its inclusion in the netting set when calculating the aggregate exposure of that netting set. A bank shall verify that transactions are assigned to the appropriate netting set within the model;

b) allow for reporting of existing margin agreements; the EPE model shall also include the current and future amount of the margin deposit, the nature of margin agreements (unilateral or bilateral), the frequency of margin calls, the margin period of risk, the minimum threshold of the margin agreement, and the minimum transfer amount; such a model shall either model the mark-to-market change in the value of collateral posted or apply the requirements under Chapter Six *Credit Risk Mitigation*;

5. the model validation process shall include back-testing at regular intervals on representative counterparty portfolios (actual or hypothetical) of transactions with counterparties; these representative portfolios shall be chosen based on their sensitivity to the material risk factors and correlations to which the bank is exposed.

(2) Where back-testing results indicate that the model is not sufficiently accurate, the BNB shall:

1. revoke the model approval; or

2. increase the capital requirement as per Article 11, paragraph 4; or

3. impose other appropriate measures to ensure that the model is improved.

Section Seven

NETTING AGREEMENTS

Types of Agreements

Article 259. (1) For the purpose of reducing counterparty credit risk, the BNB may recognise the following types of contractual netting:

1. a contract for novation between a bank and its counterparty under which mutual claims and obligations are automatically amalgamated in such a way that this novation fixes one single net amount each time novation applies and thus creates a legally binding, single new contract extinguishing former contracts;

2. contractual cross product netting agreements between banks that have received approval by the BNB to use the Internal Based Models Method, except if those are concluded between members of the same financial group;

3. other bilateral agreements between a bank and its counterparty.

(2) A contractual cross product netting agreement means a written bilateral agreement between a bank and its counterparty which creates a single legally binding obligation covering all included bilateral master agreements and transactions belonging to the following different product categories:

1. repurchase transactions, reverse repurchase transactions, securities and commodities lending and borrowing transactions;

2. margin lending transactions;

3. the contracts listed in Appendix 1 *List of Derivatives*.

(3) Netting of trading and banking portfolio positions under netting agreements covering repurchase transactions and securities and commodities lending and borrowing transactions and other credit market transactions shall be recognised where the transactions meet the following conditions:

1. they are marked to market on a daily basis;

2. all positions exchanged under these transactions meet the requirements of eligible financial collateral under Chapter Six *Credit Risk Mitigation*, whereas Article 232, paragraph 3 shall not apply.

Conditions for Recognition of Netting Agreements

Article 260. (1) The BNB may recognise netting agreements only where they meet all of the following conditions:

1. they are executed in writing;

2. the bank must have a contractual netting agreement with its counterparty which creates a single legal obligation, covering all included transactions, such that, in the event of a counterparty's failure to perform owing to default, bankruptcy, liquidation or any other similar circumstance, the bank would have a claim to receive or an obligation to pay only the net sum of the positive and negative mark-to-market values of included individual transactions;

3. the bank must have made available to the BNB a written and reasoned legal opinion to the effect that, in the event of a legal challenge before the relevant courts and administrative authorities, the same would find that the bank's claims and obligations would be limited to the net sum under paragraph 2, under:

a) the law of the jurisdiction in which the counterparty is incorporated and, if a foreign branch of the counterparty is involved, also under the law of the jurisdiction in which the branch is located;

b) the law that governs the individual transactions included;

c) the law that governs any contract or agreement necessary to effect the contractual netting;

4. the bank must have procedures in place to ensure the legal validity of its contractual netting with the relevant laws under item 3;

5. the bank maintains all required documentation;

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

7. the effects of netting shall be factored into the bank's measurement of each counterparty's aggregate credit risk exposure and the bank manages its CCR on such a basis;

8. a netting agreement shall containing no provision which permits a non-defaulting counterparty to make limited payments only, or no payments at all, to the estate of the defaulter, even if the defaulter is a net creditor under item 2 (a "walkaway" clause).

(2) Contractual cross-product netting agreements shall meet the following criteria:

1. the net sum referred to in paragraph 1, item 2 shall be the net sum of the positive and negative close out values of any included individual bilateral master agreement and of the positive and negative mark-to-market value of the individual transactions (the "Cross-Product Net Amount");

2. the opinion under paragraph 1, item 3 shall address the validity and enforceability of the entire contractual cross-product netting agreement under its terms and the impact of the netting arrangement on the material provisions of any included individual bilateral master agreements;

3. the bank shall have procedures in place under paragraph 1, item 4 to verify that any transaction which is to be included in a netting set is covered by a legal opinion; and

4. a bank shall comply with the requirements for the recognition of bilateral netting and the requirements of Chapter Six *Credit Risk Mitigation* for the recognition of credit risk mitigation with respect to each included individual bilateral master agreement and transaction.

(3) For granting the approval under paragraph 1, the BNB must be satisfied that the netting agreement is legally valid under the applicable law and, if necessary, it shall consult the competent authorities concerned.

Effects of Recognition of Netting Agreements under the Mark-to-Market Method

Article 261. Netting agreements under the Mark-to-Market Method shall be recognised as follows:

1. for contracts for novation, the replacement cost under Article 238 shall be calculated based on the net amounts of transactions covered by the netting agreements. No netting of notional transaction amounts shall be permitted;

2. for other netting agreements, the exposure value shall be the sum total of:

a) the current replacement cost for the contracts included in a netting agreement. Where the sum total is a negative value, the current replacement cost shall be zero;

b) the figure for the potential future credit exposure for all contracts included in a netting agreement, which a bank may reduce according to Formula 6 of Appendix 7 *Counterparty Credit Risk*. Any perfectly matching contracts included in the netting agreement may be taken into account as a single contract with a notional principal equivalent to the net receipts. Perfectly matching contracts are forward foreign-exchange contracts or similar contracts in which the cash flows fall due on the same value date, and which are denominated fully or partially in the same currency, and their principals are equal to the respective cash flows.

Chapter Nine
SETTLEMENT RISK

General Provisions

Article 262. (1) In the case of transactions in which debt instruments, equities, foreign currencies and commodities (excluding repurchase and reverse repurchase agreements and securities or commodities lending and securities or commodities borrowing) are unsettled after their due delivery dates, a bank shall calculate the price difference to which it is exposed. This is the difference between the agreed settlement price for the debt instrument, equity, foreign currency or commodity in question and its current market value, where the difference could involve a loss for the bank.

(2) (repealed; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011)

(3) The capital charge shall be the price difference under paragraph 1 multiplied by the appropriate potential loss factor in column 2 of Table 1 of Appendix 8 *Settlement Risk*.

(4) In cases of a system wide failure of a settlement or clearing system, BNB may waive the capital requirements calculated as set out in paragraph 3 and Article 263 until the situation is rectified. In this case, the failure of a counterparty to settle a trade shall not be deemed a default for purposes of credit risk.

(5) (new; Darjaven Vestnik, issue 38 of 2008, effective as of 11 April 2008) Each bank shall immediately notify the BNB of any contractual obligations default of its counterparties on repurchase or reverse repurchase transactions and securities or commodities lending/borrowing transactions.

Settlement Risk Entailed in Free Deliveries

Article 263. (1) A bank shall calculate the capital charge for settlement risk of free deliveries in accordance with paragraph 2 if:

1. it has paid for securities, foreign currencies or commodities before receiving them or it has delivered securities, foreign currencies or commodities before receiving payment for them;

2. in the case of cross-border transactions, one day or more has elapsed since it made that payment or delivery.

(2) The treatment of settlement risk exposures of free deliveries shall be as follows:

1. no capital charge shall be calculated up to first contractual payment or delivery leg;

2. from the first contractual payment or delivery leg up to four days after second contractual payment or delivery leg, the exposure shall be treated as an exposure to credit risk;

3. from 5 business days post second contractual payment or delivery leg until extinction of the transaction, value transferred plus current positive exposure shall be deducted from the capital base/own funds.

(3) In applying a risk weight to free delivery exposures treated according to paragraph 2, item 2, banks using an Internal Ratings Based Approach may assign PDs to counterparties, for which they have no other non-trading book exposure, on the basis of the counterparty's external rating. Banks using own estimates of LGDs may apply the LGD set out in Article 75, provided that they apply them to all such exposures.

(4) Bank using the Internal Rating Based Approach may use the risk weights under the Standardised Approach if this treatment is applied to all such exposures.

(5) Banks under paragraph 4 may apply a 100% risk weight to all such exposures to settlement risk of free deliveries.

(6) A risk weight of 100% shall be applied if the amount of positive exposure resulting from free delivery transactions is immaterial.

PART III

CAPITAL REQUIREMENTS FOR MARKET RISK

Chapter Ten

MARKET RISK – GENERAL PROVISIONS

Article 264. (1) Market risk shall be the risk of losses, arising from movements in the market prices of debt (interest rate related) and equity instruments in the trading book and of foreign exchange and commodity instruments in the trading and banking book.

(2) The capital requirement for market risk as well as the risk weighted assets under Article 22, paragraph 3, item 2 shall be calculated by one of the following approaches:

1. Standardised Approach for market risk under Chapter Eleven *Capital Requirements for Position Risk*, Chapter Twelve *Capital Requirements for Foreign Exchange Risk* and Chapter Thirteen *Capital Requirements for Commodity Risk*;

2. Internal Model Based Approach under Chapter Fifteen *Internal Models*; or

3. combination of the two approaches

(3) The bank shall implement policies and processes for the measurement and management of all material sources and effects of market risks.

Chapter Eleven
CAPITAL REQUIREMENTS FOR POSITION RISK

Section One
GENERAL PROVISIONS

Components of Position Risk

Article 265. (1) Position risk shall be the risk of a change in the prices of debt and equity instruments in the trading book.

(2) Position risk shall be divided into two components:

1. specific position risk shall be the risk of a price change in a financial instrument due to factors related to its issuer or, in case of a derivative, the issuer of the underlying instrument;

2. general position risk shall be the risk of a price change in a financial instrument due to a change in the level of interest rates in the case of a traded debt instrument or derivative, or in the case of an equity instrument or derivative to equity market movements unrelated to specific attributes of individual instruments.

Calculating Net Positions

Article 266. (1) Net position shall be the excess of a bank's long (short) positions over its short (long) positions in the same equity or debt instruments, convertible securities and identical financial futures, options, warrants and covered warrants.

(2) Netting between short and long positions in a financial instrument shall be allowed when they have the same issuer, are denominated in the same currency, have the same coupon conditions, become due on the same date, and in case of bankruptcy are treated identically.

(3) In calculating the net position, positions in derivative instruments shall be treated as positions in the underlying instruments. Netting between a convertible bond and a position in the underlying asset shall not be allowed.

(4) All net positions, irrespective of their signs, shall be converted on a daily basis into BGN at the BNB's exchange rate.

Treatment of Futures and Forwards

Article 267. (1) For the purposes of this article, long position shall mean a position in which a bank has fixed the interest rate it will receive in the future; and short position shall mean a position in which the bank has fixed the interest rate it will pay in the future.

(2) Interest-rate futures, forward-rate agreements (FRAs) and forward commitments to buy or sell debt instruments shall be treated as combinations of long and short positions, as follows:

1. a long interest-rate futures position shall be treated as a combination of a borrowing maturing on the delivery date of the futures contract and a holding of an asset with a maturity date equal to that of the instrument or the position underlying the futures contract in question;

2. a sold forward-rate agreement shall be treated as a long position with a maturity date equal to the settlement date, plus the contract period, and as a short position with a maturity date equal to the settlement date;

3. a forward commitment to buy a debt instrument shall be treated as a combination of a short position in a borrowing maturing on the delivery date and a long (spot) position in the debt instrument itself.

(3) In calculating the capital required against specific risk for the instruments under items 1 and 2, both the borrowing and the asset holding shall be included in the first category set out in Table 1 in Appendix 9 *Market Risks*, as these bear a zero specific risk;

(4) In calculating the capital required against specific risk for the instrument under item 3, the borrowing shall be included in the first category set out in Table 1 in Appendix 9 *Market Risks*, as it bears a zero specific risk, and the debt instrument shall be included under whichever category is appropriate for it in Table 1 in Appendix 9 *Market Risks*.

Options Treatment

Article 268. Options shall be treated as follows:

1. options on interest rates, debt or equity instruments, equity indices, financial futures, swaps and exchange rates shall be treated as positions equal in value to the amount of the underlying instrument to which the option refers, multiplied by its delta; the delta equivalent position may be netted off against any position in the underlying instrument or the delta equivalent of other derivatives on it;

2. with the BNB's approval, the capital requirement for a bought exchange-traded or OTC option may be the same as that for the instrument underlying it, subject to the constraint that the resulting requirement does not exceed the market value of the option;

3. banks shall allocate capital for the other risks, apart from the delta risk, associated with options when these risks are material.

Warrants Treatment

Article 269. Warrants relating to debt or equity instruments shall be treated in the same way as options under Article 268.

Swaps Treatment

Article 270. Swaps shall be treated in the same way as on-balance sheet instruments, and thus an interest rate swap under which the institution receives floating-rate interest and pays fixed-rate interest shall be treated as a combination of a long position in a floating-rate instrument of maturity equivalent to the period until the next interest fixing and a short position in a fixed-rate instrument with the same maturity as the swap itself.

Sensitivity Model to Calculate the Positions in Derivative Instruments

Article 271. (1) A bank which marks to market and manages the interest rate risk on derivative instruments on a discounted-cash-flow basis may use a sensitivity model to calculate the positions, and this model must be approved by the BNB. This model may also be used for any bond whose principal is amortised over its residual life. This model should generate positions which have the same sensitivity to interest-rate changes as the underlying cash flows. This sensitivity shall be assessed with reference to independent movements in sample rates across the yield curve, with at least one sensitivity point in each of the maturity bands set out in Table 2 under Appendix 9 *Market Risks*. The positions shall be included in the calculation of capital requirements according to the conditions of the maturity-based or duration-based approach.

(2) A bank which does not use a model under paragraph 1, with the BNB's approval, may treat as fully offsetting any positions in derivative instruments which meet the following conditions:

1. the positions are of the same value and denominated in the same currency;
2. the reference interest rates (for floating-rate positions) or coupons (for fixed-rate positions) are closely matched;
3. the residual maturities of fixed-coupon positions or the next interest-fixing dates for variable-coupon positions correspond to the following limits:

a) less than one month: same day;
b) between one month and one year: the difference is within seven days;
c) over one year: the difference is within 30 days.

Treatment of Repo Transaction and Securities Lending Transactions

(Title amended; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011)

Article 272. In a repo transaction and a securities lending which meets the criteria for being included in the trading book, the transferor of securities or guaranteed rights relating to title to securities shall include these securities in the calculation of its capital requirement under this Chapter.

Treatment of the Protection Seller in the Case of Credit Derivatives

Article 273. (amended; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) The party that assumes the credit risk (the protection seller) shall use the notional amount of the credit derivative when calculating the capital requirement for position risk, unless specified differently. The bank may elect to replace the notional value by the notional value minus any market value changes of the credit derivative since trade inception. For the purpose of calculating the specific risk charge, the maturity of the credit derivative contract shall be applicable instead of the maturity of the obligation, unless the contract is a total return swap. Positions shall be determined as follows:

1. a total return swap creates a long position in the general position risk of the reference obligation and a short position in the general position risk of a government bond with a maturity equivalent to the period until the next interest fixing; the total return swap also creates a long position in the specific risk of the reference obligation;

2. a credit default swap does not create a position for general position risk. For the purposes of specific risk, a bank must record a synthetic long position in an obligation of the reference entity, and when the derivative is rated externally and meets the conditions for a qualifying debt item, a long position in the derivative is recorded; if premium or interest payments are due under the derivative, these cash flows must be represented as notional long positions in government bonds;

3. a single name credit linked note creates a long position in the general position risk; for the purpose of specific risk, a synthetic long position is created in an obligation of the reference entity and a long position in the issuer of the note; where the credit linked note has an external rating and meets the conditions for a qualifying debt item, a single long position with the specific risk need only be recorded, depending on the rating given to the derivative;

4. a multiple name credit linked note providing proportional protection creates a long position in specific risk of the issuer of the note and a position in each reference entity, with the total notional amount of the contract assigned across the positions according to the proportion of the total notional amount that each exposure to a reference entity represents; where a reference entity has more than one obligation, the obligation with the highest risk weighting determines the specific risk; where a multiple name credit linked note has an external rating and meets the conditions for a qualifying debt item, a single long position with the specific risk of the note need only be recorded, depending on the rating of the derivative;

5. a first-asset-to-default credit derivative creates positions for the notional amount in an obligation of each reference; if in this case the capital requirement is larger than the size of the maximum credit event payment, the maximum payment amount represents the capital requirement for specific risk;

6. a second-asset-to-default credit derivative creates positions for the notional amount in an obligation of each reference entity less one (that with the lowest specific risk capital requirement); if in this case the capital requirement is larger than the size of the maximum credit event payment, the maximum payment amount represents the capital requirement for specific risk;

7. (amended; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) where an n-th-to-default credit derivative is externally rated, the protection

seller shall calculate the specific risk capital charge using the rating of the derivative and apply the respective risk weights pursuant to Chapter Seven *Securitisation* as applicable.

Treatment of the Protection Buyer in the Case of Credit Derivatives

Article 274. (1) For the party who transfers credit risk (the protection buyer), the positions shall be determined as the mirror image of the protection seller, with the exception of a credit linked note as it entails no short position in the issuer.

(2) If at a given moment there is a call option in combination with a step-up, such moment shall be treated as the maturity of the protection.

(3) (new; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) Where a credit institution obtains credit protection for a number of reference entities underlying a credit derivative under the terms that the first default among the assets shall trigger payment and that this credit event shall terminate the contract, the credit institution may offset specific risk for the reference entity to which the lowest specific risk percentage charge among the underlying reference entities applies according to Table 1 of Appendix 9 *Market Risks*.

(4) (former paragraph 3; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) In the case of n^{th}-to-default credit derivative, the protection buyer may off-set the specific risk for n-1 of the underlying exposures (i.e. the n-1 assets with the lowest specific risk charge).

Section Two

DEBT INSTRUMENTS

General Provisions

Article 275. Banks shall classify their net positions in debt instruments according to the currency in which they are denominated and shall calculate their capital requirements for general and specific risk in each currency separately.

Specific Risk of Debt Instruments

Article 276. (1) Banks' positions in their own debt instruments shall be disregarded in calculating specific risk.

(2) (amended; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) Banks shall include their net positions in instruments that are not securitisation positions, as calculated in accordance with Article 266 to the appropriate categories in Table 1 of Appendix 9 *Market Risks*, on the basis of their issuer/obligor, external or internal credit assessment, and residual maturity, and then multiply them by the weightings shown in the table. For calculating the specific risk capital charge, a bank shall sum its weighted positions (regardless of whether they are long or short). Capital requirements against specific risk for positions that are securitisation positions shall be calculated in accordance with Article 276b.

(3) Covered bonds, which meet the requirement under Article 41, paragraphs 2 – 4, may receive risk weight according to paragraph 2, reduced under the treatment of Article 41, paragraph 1 in accordance with the assigned credit quality step of the issuer.

(4) In applying the credit quality steps for the needs of Table 1 in Appendix 9 *Market Risks*, the obligor of a bank using an internal ratings based approach shall have an internal rating with a PD equivalent to or lower than that associated with an obligor-corporate having the same credit quality step under the standardised approach for credit risk.

(5) (new; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) The bank may cap the product of the risk weight and the net position at the maximum possible default-risk related loss. For a short position, that limit may be calculated as a change in value due to the underlying names immediately becoming default risk-free.

(6) (former paragraph 5; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) Securitisation positions that would be subject to a deduction under Article 230, shall be subject to a capital charge that is no less than that set out in this treatment.

(7) (former paragraph 6; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) Unrated liquidity facilities shall be subject to a capital charge that is no less than that set out in Section Four *Calculation Procedures* of Chapter Seven *Securitisation Framework.*

(8) (former paragraph 7; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) The manner in which the debt instruments are assessed shall be subject to scrutiny by the BNB, which may overturn the judgement of the bank if the BNB considers that the instruments concerned are subject to too high a degree of specific risk to be qualifying items.

(9) (former paragraph 8; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) The BNB shall require the bank to apply the maximum weighting shown in Table 1 in Appendix 9 *Market Risks* to the instruments that bear additional risk because of the insufficient insolvency of the issuer.

Treatment of the Correlation Trading Portfolio

Article 276a. (new; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) (1) The correlation trading portfolio shall consist of securitisation positions and n-th-to-default credit derivatives that meet the following criteria:

1. the positions are neither re-securitisation positions, nor options on a securitisation tranche, nor any other derivatives of securitisation exposures that do not provide a pro-rata share in the proceeds of a securitisation tranche;

2. all reference instruments are either single-name instruments, including single-name credit derivatives for which a liquid two-way market exists, or commonly-traded indices based on those reference entities.

(2) Positions which reference either of the following shall not be part of the correlation trading portfolio:

1. a claim that is capable of being assigned to the exposure classes referred to in Article 25, paragraph 1, items 8 and 9;

2. a claim on a special investment purpose entity.

(3) An institution may include in the correlation trading portfolio positions which do not meet the conditions under paragraph 1 but which hedge other positions of that portfolio, provided that a liquid two-way market exists for the instrument or its underlyings.

(4) A bank may determine the larger of the following amounts as the specific risk charge for the correlation trading portfolio:

1. the total specific risk capital charges that would apply just to the net long positions of the correlation trading portfolio;

2. the total specific risk capital charges that would apply just to the net short positions of the correlation trading portfolio.

Treatment of Securitisation Position for Specific Risk

Article 276b. (new; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) (1) For instruments in the trading book that are securitisation positions, the bank shall weight with the following its net positions as calculated in accordance with Article 266:

1. for securitisation positions that would be subject to the Standardised Approach for credit risk in the same bank's non-trading book, 8% of the risk weight under the Standardised Approach as set out in Section Four *Calculation Procedures* in Chapter Seven *Securitisation*;

2. for securitisation positions that would be subject to the Internal Ratings Based Approach in the same bank's non-trading book, 8% of the risk weight under the Internal Ratings Based Approach as set out in Section Four *Calculation Procedures* in Chapter Seven *Securitisation*.

(2) The Supervisory Formula Method may be used only with the BNB approval by banks other than an originator institution that may apply it for the same securitisation position in its non-trading book. Where relevant, estimates of PD and LGD shall be determined in accordance with Chapter Five *Calculation of Capital Requirements for Credit Risk by Using Internal Models* or alternatively and subject to a separate BNBapproval, based on estimates that are derived from an approach set out in Article 315a and that are in line with the quantitative standards for the Internal Ratings Based Approach.

(3) For securitisation positions that would be subject to a risk weight in accordance with Article 194a, paragraph 12 if they were in the same bank's non-trading book, 8% of the corresponding risk weight.

(4) The bank shall sum the absolute amounts of its weighted positions resulting from the application of this Article (regardless of whether they are long or short) in

order to calculate its capital requirement against specific risk for its securitisation positions.

General Risk of Debt Instruments

Article 277. (1) In calculating the general position risk arising from debt financial instruments, banks shall apply a maturity-based or a duration-based approach.

(2) The use of a duration-based approach or the termination of this use shall be allowed by the BNB Deputy Governor in charge of the Banking Supervision Department, on the basis of a written application accompanied by the relevant documents.

(3) A separate maturity-band table shall be prepared for each currency, and the capital charge for each currency shall be calculated separately.

Maturity-Based Approach for General Risk

Article 278. (1) Under a maturity-based approach for calculating the capital requirement for general position risk of debt instruments, a bank shall weigh the net positions of the debt instrument according to maturity. Long and short positions in debt instruments shall be assigned to the appropriate maturity bands (column 02 or 03) in Table 2 of Appendix 9 *Market Risks*, grouped into three zones.

(2) Fixed-rate instruments shall be assigned on the basis of residual maturity, and variable-rate instruments – on the basis of the period until the interest rate is next be changed.

(3) The net position on each debt instrument shall be assigned to the appropriate maturity band of Table 2 in Appendix 9 *Market Risks*, according to the coupon interest rate, and shall be multiplied by the respective risk weight from column 04.

(4) The bank shall separately sum the weighted long and the weighted short positions in each maturity band. The amount of weighted long positions which are matched by the weighted short positions in a maturity band shall be the matched weighted position for that band. The residual long or short positions shall be the unmatched weighted position for the same band.

(5) The bank shall calculate the total of the matched weighted positions in all bands.

(6) The bank shall calculate the total of the unmatched long, or short, positions in all bands included in each of the three zones. The weighted long and the weighted short positions for each zone shall be matched so as to get the matched weighted position for each zone. The remaining unmatched part of the weighted long or weighted short position shall be the unmatched weighted position for that zone.

(7) In order to get the matched weighted position between zones I and II, the bank shall match the unmatched weighted long (short) position in zone I with the unmatched weighted short (long) position in zone II. The remainder of the unmatched weighted position in zone II shall then be matched with the remainder of the unmatched weighted position in zone III.

(8) Having done the matching, the bank shall match the remaining unmatched weighted positions between zone I and zone III.

(9) Following the calculations under paragraphs 7 and 8, the bank shall sum the remainder of the unmatched weighted positions between the zones.

(10) The capital requirement shall be calculated as the sum of:

1. 10% of the sum of the matched weighted positions in all maturity bands;

2. 40% of the matched weighted position in zone I;

3. 30% of the matched weighted positions in zone II;

4. 30% of the matched weighted positions in zone III;

5. 40% of the matched weighted positions between zones I and II and between zones II and III;

6. 150% of the matched weighted positions between zones I and III;

7. 100% of the residual unmatched weighted positions.

Duration-based Approach for General Risk

Article 279. (1) Under a duration-based approach, a bank shall calculate debt instruments' yield to maturity, and for the variable-rate instruments it shall use the assumption that the principal is due when the interest rate can next be changed.

(2) Having determined the yield to maturity, the bank shall calculate the modified duration of each debt instrument on the basis of Formula 1 in Appendix 9 *Market Risks*.

(3) The bank shall allocate each debt instrument to the appropriate zone in Table 3 of Appendix 9 *Market Risks* on the basis of its calculated modified duration.

(4) The duration-weighted position for each instrument shall be obtained by multiplying its market price by its modified duration and by the assumed interest-rate change for that duration in column 03 in Table 3 in Appendix 9 *Market Risks*.

(5) The bank shall calculate its duration-weighted long and its duration-weighted short positions within each zone. The matched and the unmatched duration-weighted positions shall be determined under Article 278, paragraphs 4 – 9, assuming that each zone consists of one band.

(6) The capital requirement for general position risk of debt instruments, weighted by the duration-based approach, shall be the sum of:

1. 2% of the matched duration-weighted position for each zone;

2. 40% of the matched duration-weighted positions between zones I and II and between zones II and III;

3. 150% of the matched duration-weighted position between zones I and III;

4. 100% of the residual unmatched duration-weighted positions.

Section Three
EQUITY INSTRUMENTS

General Provisions

Article 280. (1) The capital requirement for specific risk arising from equity instruments shall be determined on the basis of the overall gross capital position, and for general risk – the overall net position.

(2) For calculating the respective capital requirements, a bank shall assign its net positions from equity instruments to the countries where they are registered on the exchanges and/or are traded in.

Specific Risk of Equity Instruments

Article 281. (1) The overall gross position shall be the sum of the absolute values of a bank's net long positions and the sum of its net short positions in equity instruments, as calculated in accordance with Article 266.

(2) (amended; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) The specific risk capital requirement shall be 8% of the overall gross position.

General Risk of Equity Instruments

Article 282. (1) The overall net position is the difference between the bank's all net long positions and its net short positions in equity instruments, calculated in accordance with Article 266.

(2) The overall net position shall be calculated for each national market separately.

(3) The capital requirement against general risk shall be the bank's overall net position multiplied by 8%.

Index Futures

Article 283. (1) Positions in stock-index futures, the delta-weighted equivalents of options in stock-index futures or equity-instrument index positions (hereinafter referred to as „index futures") may be broken down into positions in each of their constituent equity instruments. Subject to the BNB's approval for each index, these positions may be netted against opposite positions in the underlying equities. In this case the bank shall demonstrate to the BNB that it has adequate capital to cover the risk of loss caused by the future's values not moving in line with that of its constituent equities or when the bank holds opposite positions in index underlying instruments which are not identical in respect of either their maturity or their composition.

(2) Stock-index futures which are exchange traded and in the opinion of the BNB represent well diversified indices shall be subject to a capital requirement against general risk of 8%. These instruments shall be included in the calculation of the

overall net position for general risk under Article 282 and shall be disregarded in the calculation of the overall gross position for specific risk under Article 281.

(3) If a stock-index future is not broken down into its constituent underlying positions, it shall be treated as an individual equity instrument for which capital requirements for general and specific risks shall be determined. If the stock-index future is exchange traded and in the opinion of the BNB represents a well diversified index, the requirement for specific risk can be ignored.

Section Four

UNDERWRITING

Article 284. In the case of the underwriting of debt and equity instruments, the bank may use the following procedure in calculating its net positions:

1. it shall calculate the net positions by deducting the underwriting positions which are subscribed or sub-underwritten by third parties on the basis of formal agreements;
2. it shall reduce the net positions by the reduction factors in column 2 of Table 4 in Appendix 9 *Market Risks*.
3. it shall calculate its capital requirements using the reduced underwriting positions;
4. ‘working day zero’ shall be the working day on which the bank becomes unconditionally committed to accepting a known quantity of securities at an agreed price;
5. the bank shall demonstrate to the BNB that it has sufficient capital against the risk of loss which exists between the time of the initial commitment and working day 1.

Section Five

SPECIFIC RISK CAPITAL CHARGES FOR TRADING BOOK POSITIONS HEDGED BY CREDIT DERIVATIVES

Rules for Full Allowance

Article 285. (1) Full allowance shall be given for protection provided by credit derivatives when the values of two legs always move in the opposite direction and to the same extent, where:

1. the two legs consist of completely identical instruments; or
2. the long cash position is hedged by a total rate of return swap (or vice versa) and there is an exact match between the reference obligation and the underlying exposure (i.e. the cash position). The maturity of the swap itself may be different from that of the underlying exposure.

(2) In the cases under paragraph 1, a specific risk capital charge should not be applied to either side of the position.

Rules for an 80% Offset

Article 286. (1) An 80% offset shall be applied when the two legs do not consist of completely identical instruments and the following conditions are met:

1. the value of two legs always moves in the opposite direction;
2. there is an exact match in terms of the maturity of both the reference obligation and the credit derivative, and the currency of the underlying exposure and the reference obligation;
3. the key features of the credit derivative contract do not cause the price movement of the credit derivative to materially deviate from the price movements of the cash position.

(2) The specific risk capital charge for the side of the transaction with the higher capital charge shall be 20% of the latter, whereas the specific risk requirement on the other side shall be 0%.

Rules for Partial Allowance

Article 287. (1) Partial offset shall be allowed when the value of two legs usually moves in the opposite direction and one of the following conditions is met:

1. there is no match between the reference obligation and the underlying exposure of the positions under Article 285, paragraph 1, item 2, where:

a) the reference obligations ranks pari passu with or is junior to the underlying obligation;

b) the underlying obligation and the reference obligation share the same obligor and have legally enforceable cross default or cross acceleration clauses.

2. there is a currency or maturity mismatch between the credit protection and the underlying asset under Article 285, paragraph 1, item 1 or Article 286;
3. there is a mismatch between the cash position and the credit derivative of the positions under Article 286, but the underlying asset is included in the deliverable obligations in the credit derivative documentation.

(2) In the cases under paragraph 1, the higher of the two capital requirements for specific risk calculated for each side of the transaction shall apply.

Treatment under Other Cases

Article 288. In all cases not falling under Articles 285 – 287, a specific risk capital charge shall apply to both sides of the positions.

Section Six

CAPITAL CHARGES FOR POSITIONS IN COLLECTIVE INVESTMENT UNDERTAKINGS (CIUS)

General Provisions

Article 289. (1) Unless noted otherwise, positions in CIUs shall be subject to a capital requirement for position risk (specific and general) of 32%, and the sum of the capital requirements for position and foreign-exchange risk for the positions in CIUs may not be more than 40%.

(2) Unless noted otherwise, no netting shall be permitted between the underlying instruments of CIU and other positions held by the bank in these instruments.

(3) The general eligibility criteria for using the methods under Article 290 for CIUs issued by companies supervised or incorporated within the EU are the following:

1. the CIU's prospectus or equivalent document shall include:

a) the categories of assets the CIU is authorised to invest in;

b) the applicable investment limits and the methodology to calculate them;

c) the maximum level of leverage allowed;

d) the policy to limit counterparty risk arising from the allowed transactions in OTC derivatives, repo transactions and their equivalents.

2. the business of the CIU shall be reported at least twice a year to enable an assessment to be made of the assets and liabilities, income and operations over the reporting period;

3. the CIU shall give daily quotations for the buy-back of its units/shares;

4. investments in the CIU shall be segregated from the assets of the CIU manager;

5. the investing banks shall make an adequate risk assessment of the CIU.

(4) Subject to the BNB's approval, CIUs from non-EU Member States may be eligible if the requirements in paragraph 3 are met.

Calculation Procedures

Article 290. (1) Where a bank is aware of the underlying investments of the CIU on a daily basis, it shall calculate the capital requirements for position risk in accordance with the methods set out in this Section or by an approved internal model. Positions in CIUs shall be treated as positions in the underlying investments. Netting shall be permitted between the positions in the underlying investments of the CIU and other positions held by the bank, as long as the bank holds a sufficient quantity of units to allow the exchange for the underlying investments.

(2) The methods under paragraph1 shall apply to positions assumed to replicate the composition, risk and performance of an externally generated index or a fixed basket of equity or debt instruments, provided that:

1. the purpose of the CIU is to replicate the composition, risk and performance of an externally generated index or a fixed basket of equity or debt instruments;

2. the correlation coefficient between daily price movements of the CIU and the index or basket of equity or debt instruments for a minimum period of six months shall be not less than 0.9.

(3) Where a bank is not aware of the underlying instruments of the CIU on a daily basis, it shall calculate the capital requirements for position risk in accordance with the methods set out in this Chapter, provided that:

1. it will assume that the CIU first invests to the maximum extent allowed under its investment limits in assets with the highest capital requirement for position risk, and then continues making investments in descending order until the maximum total investment limit is reached; the position in the CIU will be treated as a direct holding in the assumed positions;

2. in calculating the capital charge for position risk, the bank shall take account of the maximum indirect exposure that it could achieve by taking leveraged positions through the CIU and shall proportionally increase the position in the CIU up to the maximum exposure to the underlying investments allowed by the investment limits;

3. should the capital requirement for position risk under this approach exceeds that set out in Article 289, paragraph 1, the capital requirement shall be capped at that level.

Third-party Calculations

Article 291. For calculating and reporting capital requirements for position risk for positions in CIUs, banks may rely on a third party, provided that the correctness of the calculations in the reports is ensured.

Chapter Twelve

CAPITAL REQUIREMENTS FOR FOREIGN EXCHANGE RISK

Section One

GENERAL PROVISIONS

Article 292. (1) A bank shall calculate a capital requirement for foreign exchange risk arising from the positions in its banking and trading books if the sum of the bank's overall net open foreign exchange position and its net gold position exceeds 2% of its total own funds.

(2) The capital requirement for foreign exchange risk shall be calculated by multiplying the sum of the overall net foreign exchange position and the net gold position by 8%.

(3) The capital charge for foreign exchange risk may also be calculated in accordance with Chapter Fifteen *Internal Models*.

Section Two
DETERMINANTION OF CURRENCY POSITIONS

General Provisions

Article 293. A bank's net open position (positive or negative) in each currency and in gold shall be the sum of the following elements:

1. the net spot position shall be the difference between all asset items and all liability items in the respective currency, including accrued interest (for gold – the net spot position in gold);
2. the net forward position (i.e. all amounts to be received less all amounts to be paid under forward exchange and gold transactions, including currency and gold futures and the principal on currency swaps not included in the spot position);
3. irrevocable guarantees and similar instruments in the respective currency, which are certain to be called but are not yet in the balance sheet;
4. net future income/expenses not yet accrued but already fully hedged;
5. the net delta equivalent of foreign exchange and gold options, calculated in accordance with Chapter Fourteen *Treatment of Options*;
6. the market value of options other than those in item 5.

Determination of CIU's Positions

Article 294. (1) If the bank is not aware of the foreign exchange positions in a CIU, it shall assume that the CIU's investments in foreign exchange instruments reach the maximum extent allowed by its investment limits.

(2) The bank shall take account of the maximum indirect exposure that it could achieve by taking leveraged positions through the CIU. This shall be done by proportionally increasing the position in the CIU up to the maximum exposure to the underlying investments under the investment limits.

(3) The assumed position of the CIU in foreign exchange shall be treated as a separate currency, and, if it is known weather this position is long or short, the total long position shall be added to the total long open foreign exchange position and the total short position shall be added to the total short open foreign exchange position.

(4) No netting shall be allowed between positions in different CIUs prior to the calculation.

(5) In calculating foreign exchange positions generated by investments in a CIU, a bank may rely on a third party to report the foreign exchange positions of the CIU, where the correctness of the reporting is adequately ensured.

Calculating the Net Foreign Exchange Position

Article 295. The overall net foreign exchange position shall be calculated as follows:

1. the net position in each currency, including gold, is calculated;

2. the net positions in each currency shall be converted in BGN at the BNB's exchange rate at the reporting date;

3. the net long positions shall be summed up separately from the sum of the net short positions, except the positions in Euro;

4. the overall net foreign exchange position shall be the higher of the two – the total net long position and the total net short position.

Foreign Exchange Positions Limits

Article 296. (1) Each bank shall not exceed on a daily basis the following limits:

1. for all foreign exchange positions, except positions denominated in Euro – 15%, calculated as ratio between the open foreign exchange position in each currency and the amount of own funds;

2. 30%, calculated as a ratio between the total net open position and the amount of own funds

(2) (repealed; Darjaven Vestnik, issue 38 of 2008, effective as of 11 April 2008)

Specific Treatment of Foreign Exchange Positions

Article 297. (1) The capital requirement on positions in currencies of Member States participating in the second stage of the Economic and Monetary Union shall be 1.6% of the matched position and 8% of the unmatched position.

(2) Net positions in composite currencies shall be broken down into the component currencies according to the quotas in force.

Chapter Thirteen

CAPITAL REQUIREMENTS FOR COMMODITY RISK

Section One

GENERAL PROVISIONS

General Provisions

Article 298. (1) Banks shall calculate the capital requirements to cover the risk of commodity positions (such as metals, raw materials, agricultural products) or commodity derivatives in the banking and the trading books.

(2) Each position in commodities or commodity derivatives shall be expressed in terms of the standard unit of measurement (kilogram, barrel, etc.). The spot price shall be converted in BGN at the BNB's exchange rate at the reporting date.

(3) The net position in each commodity shall be the excess of the long (short) position over the short (long) position in the same commodity and identical commodity futures, options or warrants. Banks may treat positions in commodity derivatives as positions in the underlying commodity.

(4) The following positions shall be positions in the same commodity:

1. positions in different sub-categories of commodities in cases where the sub-categories are deliverable against each other;

2. positions in similar commodities if they are close substitutes and if a minimum correlation coefficient of 0.9 between the movements in their prices can be clearly established over a minimum period of one year.

(5) Positions in gold or gold derivatives shall be subject to foreign exchange risk and included in the calculation of the foreign exchange risk capital charge.

(6) Stock financing may be excluded from the calculation of the commodity risk capital charge.

(7) The interest-rate and foreign-exchange risk of positions in commodities and commodity derivatives shall be included in the calculation of general risk for traded debt instruments and in the calculation of foreign exchange risk.

Treatment of Particular Instruments

Article 299. (1) Commodity futures and forward commitments to buy or sell individual commodities shall be measured as notional amounts in terms of the standard unit of measurement for the underlying commodity and assigned a maturity with reference to the expiry date.

(2) Commodity swaps shall be treated as follows:

1. the position is long if the bank is paying a fixed price and receiving a floating price, and short if the bank is receiving a fixed price and paying a floating price;

2. where one side of the transaction is a fixed price and the other the current market price, the swap shall be incorporated into the maturity ladder approach under Article 302, paragraph 2 as a series of positions equal to the notional amount of the contract, with one position corresponding with each payment on the swap and slotted into the maturity ladder;

3. where the two sides of the swap are in different commodities, they shall be reported in different tables under the maturity ladder approach for commodity risk.

(3) Options on commodities or on commodity derivatives shall be treated as positions equal in value to the amount of the underlying asset to which the option refers, multiplied by its delta. These positions may be netted off against any positions in the identical underlying commodity or commodity derivatives.

(4) Warrants relating to commodities shall be treated in the same way as commodity options referred to in paragraph 3

(5) The transferor of commodities or guaranteed rights relating to title to commodities in a repurchase agreement and the lender of commodities in a commodities lending agreement shall include these commodities in the calculation of its capital requirements under this Chapter.

Section Two

CALCULATING CAPITAL REQUIREMENTS FOR COMMODITY RISK

General Provisions

Article 300. In calculating the capital requirement for commodity risk, banks may use the following methods depending on their business:

1. a simple approach for commodity risk;
2. a maturity ladder approach for commodity risk.

Simple Approach for Commodity Risk

Article 301. (1) The capital requirement for commodity risk under the simple approach shall be calculated as the sum of the capital requirements for each commodity.

(2) The capital requirement for each commodity shall be the sum of:

1. 15% of the net position (long or short);
2. 3% of the gross position (long plus short).

Maturity Ladder Approach for Commodity Risk

Article 302. (1) A bank shall use a separate maturity ladder for each commodity. All positions in that commodity and the positions which are regarded as positions in the same commodity pursuant to Article 298, paragraph 4, shall be assigned to the appropriate maturity band. Physical stocks shall be assigned to the maturity band from 0 to 1 month.

(2) The maturity ladder shall have the following bands:

1. $0 \leq 1$ month;
2. $> 1 \leq 3$ months;
3. $> 3 \leq 6$ months;
4. $> 6 \leq 12$ months;
5. $> 1 \leq 2$ years;
6. $> 2 \leq 3$ years;
7. > 3 years.

(3) Positions which under Article 298, paragraph 4, are positions in the same commodity, may be offset and assigned to the appropriate maturity bands on a net basis, provided that:

1. the contracts mature on the same date;
2. the contracts mature within 10 days of each other if the contracts are traded on markets which have daily delivery dates.

(4) Banks shall calculate the sum of the long positions and the sum of the short positions in each maturity band. The amount of the long (short) position which is matched by the short (long) position in a given maturity band shall be the matched

position in that band, while the residual long or short position shall be the unmatched position for the same band.

(5) That part of the unmatched long (short) position for a given maturity band that is matched by the unmatched short (long) position for the next maturity band shall be the matched position between the two maturity bands. That part of the unmatched long or short position that cannot be thus matched shall be the unmatched position.

(6) The capital requirement for each commodity under this approach shall be the sum of:

1. the sum of the matched long and short positions for each maturity band, multiplied by 1.5%;
2. the matched position between two maturity bands for each maturity band into which an unmatched position is carried forward, multiplied by 0.6%;
3. the residual unmatched positions, multiplied by 15%.

(7) A bank's overall capital requirement for commodity risk shall be calculated as the sum of the capital requirements calculated for each commodity according to the preceding paragraph.

Chapter Fourteen
TREATMENT OF OPTIONS

General Provisions

Article 303. (1) Positions in options shall include exchange-traded and over-the-counter options or instruments whose characteristics are similar to those of options.

(2) In calculating option positions, the options for instruments which have two components (swaptions, futures options) shall be broken down, in two stages, into positions in the underlying instruments.

Delta of the Option

Article 304. (1) Delta (δ) of the option shall be the change in the option price as a proportion of a small change in the price of the instrument underlying the option. Mathematically, delta is the first derivative of the function of the option's price to the price of the underlying instruments:

$$\delta = \frac{\delta \text{ of the option's price}}{\delta \text{ of the underlying instrument's price}}$$

(2) In calculating the capital requirements, the delta-equivalent positions in the underlying instruments shall be treated as follows:

1. a purchased call option as a long position in the underlying instrument;
2. a written call option as a short position in the underlying instrument;
3. a purchased put option as a short position in the underlying instrument; and
4. a written put option as a long position in the underlying instrument.

Chapter Fifteen
INTERNAL MODELS

General Provisions

Article 305. (1) Subject to the BNB's approval, banks may use their internal risk assessment and management models to calculate their capital requirements for position risk, foreign exchange risk and/or commodity risk, instead of or in combination with the methods under Chapter Eleven *Capital Requirements for Position Risk*, Chapter Twelve *Capital Requirements for Foreign Exchange Risk* and Chapter Thirteen *Capital Requirements for Commodity Risk*.

(2) The Bulgarian National Bank shall give permission under paragraph 1 when:

1. the bank has used the model for internal purposes for not less than previous three years and for at least the last one year the bank's capital requirements have been reported to the BNB both under the standardised approach and by internal models;

2. the qualitative and quantitative standards under this Chapter are met.

(3) The use of an internal model for calculating the capital requirements for position, foreign-exchange and/or commodity risk shall be approved by the BNB, on the basis of a written application, with the relevant documents attached thereto. The approval shall be decided in 1 year period.

(4) The bank approved to use an internal model, is not allowed to revert to a Standardised Approach for risks covered by the model, unless under reasonable circumstance and after approval by BNB.

Qualitative Standards

Article 306. (1) The risk management system shall cover all material risks for the bank and shall meet the following qualitative standards:

1. the internal risk measurement model is an integral part of the bank's daily risk management process and serves as the basis for reporting risk exposures to the authorised official in the competent governing body;

2. the bank has a specialised risk control unit that is independent from business trading units and reports directly to the authorised official in the competent governing body; this unit shall be responsible for:

a) designing and implementing the risk assessment and management system;

b) producing and analysing daily reports on the output of the model and proposing appropriate measures to be taken in terms of trading limits;

c) conducting the initial and on-going validation of the internal model.

3. the bank's competent governing bodies shall be actively involved in the risk control process. The daily reports produced by the risk-control unit shall be reviewed by a level of management with sufficient authority to enforce both reductions of positions taken by individual traders and in the bank's overall exposure;

4. the bank has a sufficient number of staff skilled in the use of sophisticated models in the trading, back office, risk control and audit areas;

5. the bank has established procedures for monitoring and ensuring compliance with a documented set of internal policies and controls concerning the overall operation of the risk assessment and management system;

6. the model's historical output has proven sound, is reasonably accurate and reliably documented;

7. (amended; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) the bank frequently conducts comprehensive stress testing as well as reverse stress testing and the results of these tests are reviewed by the authorised official of the competent governing body and reflected in the policies and limits; this process shall particularly address risks that may not be captured appropriately in the VAR model, such as:

a) illiquidity of markets in stressed market conditions;

b) concentration risk;

c) one way markets;

d) event risk;

e) jump-to-default risks;

f) non-linearity of products;

j) deep out-of-the-money options;

h) positions subject to the gapping of prices.

8. the bank's internal audit unit shall conduct a review of its risk measurement system.

(2) The shocks applied under paragraph 1, item 7, shall reflect the nature of the portfolios and the time it could take to hedge out or manage risks under severe market conditions;

(3) The review under paragraph 1, item 8, shall include both the activities of the business trading units and of the independent risk control unit. At least once a year, the bank shall conduct a review of its overall risk management process which shall in all cases cover:

1. the adequacy of the documentation of the risk management system and process and the organisation of the risk control unit;

2. the integration of market risk measures into daily risk management and the integrity of the management information system;

3. the process for approving risk pricing models and the valuation systems that are used by front and back-office personnel;

4. the scope of market risks captured by the risk measurement model and the validation of any significant changes in the risk measurement process;

5. the accuracy and completeness of position data, the accuracy and appropriateness of volatility and correlation assumptions, and the accuracy of valuation and risk sensitivity calculations;

6. the verification process evaluating the consistency, timeliness and reliability of data used to run internal models, including the independence of data sources;

7. the verification process evaluating back-testing that is conducted to assess the model's accuracy.

Quantitative Standards

Article 307. (1) In calculating the value at risk, the following minimum quantitative standards shall apply:

1. at least daily calculation of the value-at-risk measure;

2. a 99^{th} percentile, one-tailed confidence interval is used;

3. (amended; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) a 10-day equivalent holding period is used to calculate the value at risk (bank may use value-at-risk numbers calculated according to shorter holding periods scaled up to 10 days as in that case a bank using that approach shall periodically justify the reasonableness of its approach to the satisfaction of the Bulgarian National Bank);

4. value at risk is calculated on the basis of an effective historical observation period of at least one year except where a shorter observation period is justified by a significant upsurge in price volatility;

5. (amended; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) the data set is updated at least once per month or more frequently when market prices are subject to significant changes.

(2) (new; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) The following minimum quantitative criteria should be met in calculation the stressed value-at-risk:

1. 99-percentile, one-tailed confidence interval value-at-risk measure of the current portfolio;

2. value-at-risk model inputs calibrated to historical data from a continuous 12-month period of significant financial stress relevant to the bank's portfolio;

3. 10-day equivalent retention period;

4. the stressed value-at-risk shall be calculated at least weekly.

(3) (former paragraph 2; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) The used model shall capture all material risks related to options or option-like positions, and any other risks not captured by the model shall be covered adequately by own funds.

(4) (new; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) The choice of the historical data under paragraph 2, item 2 shall be subject to approval by the Bulgarian National Bank and to annual review by the bank.

Risk Factors

Article 308. (amended; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) (1) The risk-measurement model shall capture a sufficient number of risk factors, depending on the level of activity of the bank in the respective markets.

(2) Where a risk factor is incorporated into the bank's pricing model but not into the risk-measurement model, the bank shall be able to justify such an omission to the satisfaction of the Bulgarian National Bank.

(3) The risk-measurement model shall capture nonlinearities for options and other products as well as correlation risk and basis risk.

(4) Where proxies for risk factors are used they shall show a good track record for the actual position held.

(5) In determining risk factors, the minimum requirements under Articles 309 – 312 shall be met.

(6) Banks may use correlation coefficient assessments between the individual risk factors when an empirical check proves that they are material. The system for measuring correlation coefficients shall be reliable and shall be used for all major factors.

Interest-Rate Risk Factors

Article 309. (1) The interest-rate-risk-measurement system shall incorporate all risk factors corresponding to the interest rates in each currency in which a bank has interest rate sensitive positions.

(2) The yield curve shall be modelled by the use of one of the generally accepted approaches. For material exposures to interest-rate risk in the major currencies and markets, the yield curve shall be divided into a minimum of six maturity segments, and each maturity segment shall correspond to one risk factor.

(3) The risk measurement system shall capture the risk of less than perfectly correlated movements between different yield curves.

Foreign-Exchange Risk Factors

Article 310. (1) The foreign-exchange-risk-measurement system shall incorporate risk factors corresponding to gold and to the individual foreign currencies in which the bank's positions are denominated.

(2) For positions in CIUs, the actual foreign exchange positions of the CIU shall be taken into account. Banks may use third party reporting of the foreign exchange positions of the CIU, where the correctness of this report is adequately ensured. If a bank is not aware of the foreign exchange positions of a CIU, these positions should be treated in accordance with Chapter Twelve *Capital Requirements for Foreign Exchange Risk*.

Equity Risk Factors

Article 311. The equity-risk-measurement system shall use a separate risk factor at least for each of the equity markets in which the bank holds significant positions.

Commodity Risk Factors

Article 312. (1) The commodity-risk-measurement system shall use a separate factor at least for each significant position in commodities.

(2) This system shall capture the risk of:

1. less than perfectly correlated movements between similar, but not identical, commodities;

2. changes in forward prices arising from maturity mismatches.

(3) The system shall also take account of market characteristics, such as delivery dates and the ways provided to traders to close positions.

Back Testing

Article 313. (1) A bank that uses internal models to calculate capital requirements for market risk shall use back testing to validate the accuracy of the model and determine a multiplication factor.

(2) The back testing shall calculate the difference between the change in the portfolio's value under paragraph 3 and the value-at-risk measure generated by the model.

(3) The change in the portfolio's value shall be calculated at once in the following two ways:

1. the actual change in the portfolio's value, excluding any changes due to fees, commissions, and net interest income;

2. hypothetical changes in the portfolio's value for the day, assuming that the end-of-day positions of the previous day remained unchanged.

(4) The BNB shall require improvement of back testing programmes if it deems that their outcomes are not reliable.

Validation of Models

Article 314. (1) The bank shall have processes in place to ensure that its internal models have been adequately validated by suitably qualified parties independent of the development process to ensure that they are conceptually sound and adequately capture all material risks. The validation shall be conducted when the internal model is initially developed and when any significant changes are made to the internal model. The validation shall also be conducted on a periodic basis but especially when there have been any significant structural changes in the market or changes to the composition of the portfolio which might lead to the internal model no longer being adequate.

(2) Internal model validation shall also include:

1. tests to demonstrate that any assumptions made within the internal model are appropriate and do not underestimate or overestimate the risk;

2. the bank's own internal model validation tests in relation to the risks and structures of portfolios;

3. the use of hypothetical portfolios to ensure that the internal model is able to account for particular structural features that may arise, for example material basis risks and concentration risk.

Special Requirements for Specific Risk

Article 315. (amended; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) (1) With BNB approval, a bank may use an internal model to calculate the capital requirements for specific risk if the internal model meets the following conditions:

1. it explains the historical price variation in the portfolio;

2. it captures concentration in terms of magnitude and changes of composition of the portfolio;

3. it is robust to an adverse environment;

4. it is validated through back-testing aimed at assessing whether specific risk is being accurately captured;

5. it captures name-related basis risk between similar but not identical positions;

6. it captures event risk.

(2) The bank's internal model shall conservatively assess the risk arising from less liquid positions and positions with limited price transparency under realistic market scenarios. Proxies shall be appropriately conservative and may be used only where available data is insufficient or is not reflective of the true volatility of a position or portfolio.

(3) A bank may choose to exclude from the calculation of its specific risk capital requirement using an internal model those positions in securitisations or n-th-to-default credit derivatives for which it meets a capital requirement for position risks in accordance Chapter Eleven *Capital Requirements for Position Risk* with the exception of those positions that are subject to the approach set out in Article 315e.

(4) A bank shall not be required to capture default and migration risks for traded debt instruments in its internal model where it is capturing those risks through the requirements set out in Articles 315a – 315d.

(5) A bank using internal models which are not approved by the Bulgarian National Bank under this Article shall charge a separate capital requirement for specific risk under Chapter Eleven *Capital Requirements for Position Risk.*

Incremental Default and Migration Risk

Article 315a. (new; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) (1) A bank subject to Article 315 for traded debt instruments shall have an approach in place to capture, in the calculation of their capital requirements, the default and migration risks of its trading book positions that are incremental to the risks captured by the value-at-risk measure as specified in Article 315. A bank shall demonstrate that its approach meets soundness standards comparable to the approach set out in Chapter *Calculation of Capital Requirements for Credit Risk by Using Internal Models*, under the assumption of a constant level of risk, and adjusted where appropriate to reflect the impact of liquidity, concentrations, hedging and optionality.

(2) The approach to capture the incremental default and migration risks shall cover all positions subject to a capital charge for specific interest rate risk but shall not cover securitisation positions and n-th-to-default credit derivatives.

(3) The approach under paragraph 2 shall reflect the impact of correlations between default and migration events. The impact of diversification between, on the one hand, default and migration events and, on the other hand, other market risk factors shall not be reflected.

(4) With approval by the Bulgarian National Bank, a bank may choose to consistently include the approach under paragraph 2 for all listed equity positions and derivatives positions based on listed equities for which such inclusion is consistent with how the bank internally measures and manages risk.

(5) The approach to capture the incremental risks under paragraph 2 shall measure losses due to default and internal or external ratings migration at the 99.9-percentage confidence interval over a capital horizon of 1 year.

(6) Correlation assumptions shall be supported by analysis of objective data in a conceptually sound framework. The approach under 2 shall appropriately reflect issuer concentrations. Concentrations that can arise within and across product classes under stressed conditions shall also be reflected.

(7) The approach under paragraph 2 shall reflect the non-linear impact of options, structured credit derivatives and other positions with material non-linear behaviour with respect to price changes. The bank shall also have due regard to the amount of model risk inherent in the valuation and estimation of price risks associated with such products.

(8) The approach under paragraph 2 shall be based on data that are objective and up-to-date.

Liquidity Horizons

Article 315b. (new; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) (1) The assumption of a constant level of risk under Article 315a, paragraph 1 over the one-year capital horizon, implying that given individual trading book positions or sets of positions that have experienced default or migration over their liquidity horizon are re-balanced at the end of their liquidity horizon to attain the initial level of risk. Alternatively, a bank may choose to consistently use a one-year constant position assumption.

(2) The liquidity horizons shall be set according to the time required to sell the position or to hedge all material relevant price risks in a stressed market, having particular regard to the size of the position. Liquidity horizons shall reflect actual practice and experience during periods of both systematic and idiosyncratic stresses. The liquidity horizon shall be measured under conservative assumptions and shall be sufficiently long that the act of selling or hedging, in itself, would not materially affect the price at which the selling or hedging would be executed.

(3) The determination of the appropriate liquidity horizon for a position or a set of positions shall take into account a bank's internal policies relating to valuation adjustments and the management of stale positions. When an institution determines liquidity horizons for sets of positions rather than for individual positions, the criteria for defining sets of positions shall be determined in a way that meaningfully reflects differences in liquidity.

(4) The liquidity horizons shall be greater for positions that are concentrated, reflecting the longer period needed to liquidate such positions. The liquidity horizon for a securitisation warehouse shall reflect the time to build, sell and securitise the assets, or to hedge the material risk factors under stressed market conditions.

(5) The determination of the appropriate liquidity horizon for a position or set of positions is subject to a floor of 3 months.

Recognition of hedging techniques in additional risks treatment

Article 315c. (new; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) Hedges may be incorporated into an institution's approach to capture the incremental default and migration risks where the following conditions are met:

1. positions may be netted when long and short positions refer to the same financial instrument;

2. hedging or diversification effects associated with long and short positions involving different instruments of the same obligor, as well as long and short positions in different issuers, may only be recognised by explicitly modelling gross long and short positions in the different instruments;

3. banks shall reflect the impact of material risks that could occur during the interval between the hedge's maturity and the liquidity horizon as well as the potential for significant basis risks in hedging strategies by product, seniority in the capital structure, internal or external rating, maturity, vintage and other differences in the instruments;

4. a bank shall reflect a hedge only to the extent that it can be maintained even as the obligor approaches a credit or other event;

5. for trading book positions that are hedged via dynamic hedging strategies, a rebalancing of the hedge within the liquidity horizon of the hedged position may be recognised provided that the bank:

a) chooses to model rebalancing of the hedge consistently over the relevant set of trading book positions;

b) demonstrates that the inclusion of rebalancing results in a better risk measurement;

c) demonstrates that the markets for the instruments serving as hedges are liquid enough to allow for such rebalancing even during periods of stress;

d) any residual risks resulting from dynamic hedging strategies must be reflected in the capital charge.

Requirements to the models for incremental default risk and migration risk

Article 315d. (new; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) (1) As part of the independent review of their risk measurement system and the validation of the models as required in Article 314, with a view to the approach under Article 315a, paragraph 2, banks shall:

1. validate that its modelling approach for correlations and price changes is appropriate for its portfolio, including the choice and weights of its systematic risk factors;

2. perform a variety of stress tests, including sensitivity analysis and scenario analysis, to assess the qualitative and quantitative reasonableness of the approach, particularly with regard to the treatment of concentrations; such tests shall not be limited to the range of events experienced historically;

3. apply appropriate quantitative validation including relevant internal modelling benchmarks.

(2) The approach under Article 315a, paragraph 2 shall be consistent with the bank's internal risk management methodologies for identifying, measuring, and managing trading risks.

(3) A bank shall document the correlation and other modelling assumptions used for modelling the approach under Article 315a, paragraph 2.

(4) If the bank uses the approach under Article 315a, paragraph 2 that does not comply with all requirements under Articcles 315a – 315d but that is consistent with the bank's internal methodologies for identifying, measuring and managing risks, it shall be able to demonstrate to the Bulgarian National Bank that its approach results in a capital requirement that is at least as high as if it was based on an approach in full compliance with the requirements of Articles 315a – 315d. The Bulgarian National Bank shall review the compliance as part of the supervisory review process at least annually.

(5) A bank shall perform the calculations required under its chosen approach under Article 315a, paragraph 2 at least weekly.

Internal approach for additional risks treatment

Article 315e. (new; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) (1) The Bulgarian National Bank shall recognise the use of an internal approach for calculating an additional capital charge instead of a capital charge for the correlation trading portfolio in accordance with Article 276, paragraph 4 provided that the following conditions are met:

1. such an internal approach shall adequately capture all price risks at the 99.9-percentage confidence interval over a capital horizon of one year under the assumption of a constant level of risk, and adjusted where appropriate to reflect the impact of liquidity, concentrations, hedging and optionality; the bank may incorporate any positions in the approach that are jointly managed with positions of the correlation trading portfolio and may then exclude those positions from the approach required under Article 315a, paragraph 1;

2. the amount of the capital charge for all price risks shall not be less than 8% of the capital charge that would be calculated in accordance with Article 276, paragraph 4;

3. the following risks shall be adequately captured:

a) the cumulative risk arising from multiple defaults, including the ordering of defaults, in tranched products;

b) credit spread risk, including the gamma and cross-gamma effects;

c) volatility of implied correlations, including the cross effect between spreads and correlations;

d) basis risk, including both:

i) the basis between the spread of an index and those of its constituent single names; and

ii) the basis between the implied correlation of an index and that of bespoke portfolios.

e) recovery rate volatility, as it relates to the propensity for recovery rates to affect tranche prices; and

f) to the extent the comprehensive risk measure incorporates benefits from dynamic hedging, the risk of hedge slippage and the potential costs of rebalancing such hedges.

4. a bank shall have sufficient market data to ensure that it fully captures the salient risks of those exposures in its internal approach in accordance with the standards set out in this Article; the bank demonstrates through back testing or other appropriate means that its risk measures can appropriately explain the historical price variation of those products;

5. a bank is able to separate the positions for which it holds approval in order to incorporate them in the capital charge in accordance with this Article from those positions for which it does not hold such approval.

(2) With regard to portfolios subject to the approach under paragraph 1, the bank shall regularly apply a set of specific, predetermined stress scenarios. Such stress scenarios shall examine the following stress effects on the profit and loss of the correlation trading desk:

1. default rates;

2. recovery rates;

3. credit spreads;
4. correlations.

(3) The bank shall apply stress scenarios under paragraph 2 at least weekly and report at least quarterly to the Bulgarian National Bank the results, including comparisons with the institution's capital charge in accordance with paragraph 2.

(4) Any instances where the stress tests under paragraph 2 indicate a material shortfall of the capital charge under paragraph 1 shall be reported immediately to the Bulgarian National Bank. Based on those stress testing results, the Bulgarian National Bank shall consider a supplemental capital charge against the correlation trading portfolio as set out in Article 103, paragraph 2, item 5 of Law on Credit Institutions.

(5) A bank shall calculate the capital charge under paragraph 1 to capture all price risks at least on a weekly basis.

Capital Requirements

Article 316. (amended; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) The capital requirement for a bank using an internal model approved by the Bulgarian National Bank is a sum of items 1 and 2, and for a bank using its internal model to calculate the capital requirement for specific positions risk, the amounts under items 3 and 4 shall be added to the sum of items 1 and 2, as follows:

1. the higher of:

a) its previous day's value-at-risk calculated under Article 307 paragraph 1;

b) an average of the daily value-at-risk measures on each of the preceding 60 business days, multiplied by the multiplication factor (Mc);

2. the higher of:

a) its previous day's stressed value-at-risk calculated under Article 307 paragraph 2; and

b) and average of the daily stressed value-at-risk measures on each of the preceding 60 days, multiplied by the multiplication factor (Ms);

3. a capital charge calculated in accordance with Chapter Eleven *Capital Requirements for Position Risk* for the position risks of securitisation positions and n-th to default credit derivatives in the trading book with the exception of those incorporated in the capital charge in accordance with Article 315e;

4. the higher of the bank's most recent and the institution's 12 weeks average measure of incremental default and migration risk in accordance with Articles 315d – 315d and, where applicable, the higher of the bank's most recent and its 12-week-average measure of all price risks in accordance with Article 315e.

Overshootings

Article 317. (new; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) The minimum amount of the multiplication factors under Article 316, item 1, letter "b" and item 2, letter "b" shall be at least 3.

(2) (former paragraph 1; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) The minimum values of the multiplication factors under paragraph 1 shall be increased by a plus-factor of between 0 and 1 (Table 5 of Appendix 9 *Market Risks*), depending on the number of overshootings for the most recent 250 business days as evidenced by the bank's back testing.

(3) (former paragraph 2; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) An overshooting is a one-day change in the portfolio's value that exceeds the related one-day value-at-risk measure generated by the bank's model.

(4) (former paragraph 3; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) Overshootings shall be calculated by comparing the value generated by the approaches under Article 313, paragraph 3, applied consistently.

(5) (former paragraph 4; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) For the purpose of determining the plus-factor under paragraph 2, the number of overshootings shall be assessed at least quarterly or more frequently if necessary and shall be equal to the higher of the number of the two values, calculated under the application of the two approaches pursuant to Article 313, paragraph 3.

(6) (former paragraph 5; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) The bank shall notify promptly the BNB, not later than 5 working days, for any overshootings that result from its back testing programme and that would imply an increase of a plus-factor.

(7) (former paragraph 6; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) If there are numerous overshootings, the BNB may revoke the model's recognition as it is not sufficiently accurate or impose additional requirements for its improvement.

PART FOUR

CAPITAL REQUIREMENTS FOR OPERATIONAL RISK

Chapter Sixteen

OPERATIONAL RISK – GENERAL PROVISIONS

Article 318. (1) The bank calculates capital requirements for operational risk according to the requirements of this Part by using one of the approaches under paragraph 6.

(2) Operational risk means the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, and includes legal risk;

(3) An operational event means an event that might cause a negative economic result and/or additional costs and the realised outcome differs from the expected outcome of the business.

(4) The loss of operational event is the financial effect of the occurrence of operational events and shall be subject to disclosure in banks' financial statements, including opportunity costs.

(5) Operational events leading to loss shall be classified in accordance with Table 1 of Appendix 10 *Operational Risk*.

(6) The capital requirement for operational risk shall be calculated by one of the following approaches:

1. the Basic Indicator Approach;
2. the Standardised Approach;
3. Advanced Measurement approaches.

(7) (amended; Darjaven Vestnik, issue 20 of 2010) The use of the approach under paragraph 6, item 3 shall be approved by the BNB, on the basis of a written application, with the relevant documents attached thereto, as the period for the approval is one year.

(8) (amended; Darjaven Vestnik, issue 20 of 2010) Where the bank uses one of the approaches under paragraph 6, items 2 and 3, it may not apply again a more simplified approach without prior approval by the BNB. If the BNB considers that a bank which uses the approaches under paragraph 6, items 2 and 3, no longer meets the qualifying criteria for their use, the BNB shall require that the bank apply again a more simplified approach to some or all of its operations.

(9) The bank shall implement policies and processes to evaluate and manage the exposure to operational risk, including to low-frequency high-severity events.

(10) (amended, Darjaven Vestnik, issue 21 of 2009) The bank shall have in place contingency and business continuity plans in order to ensure the bank's ability to operate on an ongoing basis and to limit losses in the event of a severe downturn caused by market factors and other reasons.

Chapter Seventeen

APPROACHES FOR MEASURING OPERATIONAL RISK

Section One

BASIC INDICATOR APPROACH

Article 319. (1) In applying the Basic Indicator Approach, bank calculates the amount of capital for covering operational risk losses by multiplying the bank's average annual gross income by a coefficient of 0.15.

(2) The average relevant indicator is calculated on the basis of the last three year average sum of net interest income and net non-interest income, derived from audited statements. When audited figures are not available, internal expert estimates may be used

(3) The average annual gross income shall be calculated as the sum of the positive values of the annual gross income, divided by the number of these values. When the annual gross income is negative, it shall not be included in the calculation of the indicator.

(4) The annual gross shall be calculated before the deduction of any impairment provisions and operating expenses. The bank shall not deduct fees paid for outsourc-

ing services rendered by an entity which is a parent or subsidiary of the bank or a subsidiary of a parent which is also the parent of the bank.

(5) Expenditure on the outsourcing of services rendered by third parties shall reduce the annual gross income if the expenditure is incurred by a regulated undertaking subject to equivalent supervision.

(6) The calculation of the annual gross income shall not include:

1. realised profits/losses from the sale of banking book securities;

2. income from extraordinary or irregular items;

3. income derived from insurance.

Section Two

STANDARDISED APPROACH

General Provisions

Article 320. (1) (amended; Darjaven Vestnik, issue 20 of 2010) The bank may use a standardised approach to calculate its capital requirements for operational risk, after it has notified the BNB.

(2) (amended; Darjaven Vestnik, issue 20 of 2010) In order to use the approach provided for in paragraph 1, the bank shall provide evidence that:

1. the requirements under Articles 321 and 322 are met; and

2. the bank has applied for internal purposes a Standardised Approach for minimum one year.

(3) Under the Standardised Approach the capital requirement for operational risk shall be derived as the sum of the capital requirements calculated for each of the last three calendar years by business line as per Table 2 of Appendix 10 *Operational Risk* and shall be given by Formula 1 of Appendix 10 *Operational Risk*.

(4) When the result for a year is negative, it shall be replaced with a zero. When audited figures are not available, internal estimates may be used.

Policies and Criteria for Mapping the Annual Gross Income

Article 321. (1) Banks shall develop and document specific policies and criteria for mapping the relevant annual gross income for the business lines into the standardised framework. The criteria shall be reviewed and adjusted as appropriate for new or changing business activities.

(2) The criteria for business line mapping are:

1. all activities must be mapped into the business lines in a mutually exclusive and jointly exhaustive manner;

2. any activity which cannot be readily mapped into the business line framework, but which represents an ancillary function to an activity included in the framework, must be allocated to the business line it supports; if more than one business line is supported through the ancillary activity, an objective-mapping criterion must be used;

3. if an activity cannot be mapped into a particular business line, then it must be mapped in the business line yielding the highest capital requirement.; the same business line equally applies to any associated ancillary activity;

4. banks may use internal pricing methods to allocate the relevant annual gross income between business lines; costs generated in one business line which are imputable to a different business line may be reallocated to the business line to which they pertain, by using a treatment based on internal transfer costs between the two business lines;

5. the mapping of activities into business lines for operational risk capital purposes must be consistent with the categories used for credit and market risks;

6. the bank's competent governing body is responsible for the mapping policy;

7. the bank's mapping process to business lines must be subject to independent review and control.

Standards for Risk Management

Article 322. (1) To qualify for the use of the Standardised Approach, the bank shall meet the following general risk management standards:

1. the bank's governing body has adopted written policies and procedures for operational risk assessment and management as well as contingency plans and plans to deal with loss in crises; it shall be involved in the operational risk control process and in the major changes to the system; the managerial roles and responsibilities can be clearly identified, including for the credit institution's subsidiaries and other undertakings that are consolidated with the bank;

2. the bank has an operational risk management system that is conceptually sound and implemented with integrity;

3. the bank's governing body must ensure that the required resources are provided, including for the internal control and internal audit.

(2) A bank applying the Standardised Approach shall meet the following additional criteria:

1. it shall have a well-documented assessment and management system for operational risk with clear responsibilities assigned for this system; they shall identify their exposures to operational risk and track relevant operational risk data, including material loss data;

2. the operational risk assessment system shall be subject to regular independent review;

3. the operational risk assessment system must be closely integrated into the risk management processes of the bank. Its output must be an integral part of the process of monitoring and controlling the exposure to risks.

Section Three

ADVANCED MEASUREMENT APPROACHES

General Provisions

Article 323. (1) (amended; Darjaven Vestnik, issue 102 of 2010, effective as of 1 January 2011) Subject to the BNB's approval under Article 318, paragraph 7, banks may use advanced measurement approaches to calculate the capital requirements for operational risk, after assessing the adequacy of the approach applied, the complexity of operations, their procedures and the level of operational risk.

(2) The Bulgarian National Bank shall grant permission under paragraph 1, when:

1. the minimum general requirements specified in Article 322, paragraph 1 are met;

2. the qualitative and quantitative standards under Articles 326 and 327 are met;

3. the approach has been applied for internal needs for not less than three years, and at least for one year the bank's capital requirements for operational risk have been reported to the BNB alongside with the Standardised Approach.

Supervisory Cooperation

Article 324. (1) When an Advanced Measurement Approach is intended to be used by an EU parent credit institution and its subsidiaries or by the subsidiaries of an EU parent financial holding company, the competent authorities of the different legal entities shall cooperate closely as provided for in Article 92 of Law on Credit Institutions.

(2) The application under paragraph 1 shall include the elements listed in Articles 323 – 329.

(3) (amended; Darjaven Vestnik, issue 102 of 2010, effective as of 1 January 2011) Where an EU parent credit institution and its subsidiaries or the subsidiaries of an EU parent financial holding company use an Advanced Measurement Approach on a unified basis, the competent authorities may allow the requirements under this section to be met by the parent and its subsidiaries considered together.

Application to Use an Advanced Measurement Approach on a Group-wide Basis

Article 325. When an Advanced Measurement Approach is intended to be used by the EU parent credit institution and its subsidiaries, or by the subsidiaries of an EU parent financial holding company, the application shall include the following:

1. a description of the methodology used for allocating operational risk capital between the different entities of the group;

2. the application shall indicate whether and how diversification effects are intended to be factored in the risk measurement system.

Qualitative Standards

Article 326. The operational-risk management system in a bank shall meet the following qualitative standards:

1. the bank's internal operational-risk-measurement system shall be closely integrated into its day-to-day risk management process;

2. the bank shall have an independent risk management function for operational risk;

3. the reporting of operational risk exposures and loss shall be prepared at least once per every three months; the bank shall have developed procedures for taking appropriate corrective measures;

4. the risk management system shall be well documented, the bank shall ensure the compliance with the legal framework and shall have a policy for the treatment of non-compliance;

5. the operational-risk-management process and the systems for measuring that risk shall be subject to regular reviews by internal and/or external auditors;

6. the validation of the operational-risk-measurement system by the BNB under Article 318, paragraph 7 shall include the following elements:

a) verifying that the internal validation process is operating in a satisfactory manner;

b) verifying that data flows and the processes related to the operational-risk-measurement system are transparent and accessible to the authorised officials.

Quantitative Standards

Article 327. (1) A bank shall calculate its operational risk capital charge, including the expected and unexpected loss, unless it can demonstrate that expected loss is captured in the adopted policy and activities. The capital requirement shall be calculated on the basis of a 99.9 percentile confidence interval for losses of operational risk over one year.

(2) The operational-risk-measurement system shall incorporate elements for soundness, among which are internal and external data, scenario analysis, business environment factors, and internal control mechanisms. The bank shall have a well-documented approach to weigh the use of these four elements in the overall operational-risk-management system.

(3) The operational-risk-management system shall capture major drivers of risk affecting the shape of the tail of the loss estimates.

(4) A bank may use correlations to reduce the operational risk loss estimates against the individual loss estimates of individual events. The recognition for regulatory purposes shall involve the credit institution proving to the BNB that the systems for assessing interdependencies are reliable, capture all operations of the bank, and take account of the volatility of the environment, even in crises. The bank shall document its suppositions about existing interdependencies by means of appropriate quantitative and qualitative techniques.

(5) The risk management system shall be used consistently and shall avoid double counting of quantitative measures or risk mitigation techniques reported elsewhere in the credit institution's capital adequacy.

Internal Data

Article 328. (1) Internally generated operational risk measurement systems shall be based on a minimum historical observation period of five years.

(2) (amended; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) The bank shall allocate its historical internal loss data into the business lines and into the event types defined in Tables 1 and 2 of Appendix 10 *Operational Risk*, using documented, objective criteria. Loss events which affect the entire institution may be allocated to an additional business line "corporate items" due to exceptional circumstances. The operational risk losses that are related to credit risk and have historically been included in the internal credit risk database shall be recorded in the operational risk database and be separately identified. Such losses will not be subject to the operational risk charge, as long as they continue to be treated as credit risk for the purposes of calculating minimum capital requirements. Operational risk losses that are related to market risks shall be included in the scope of the capital requirement for operational risk.

(3) The bank's internal loss data shall be comprehensive in that it captures all material activities and exposures from all structural units. The bank shall justify that any excluded activities or exposures (both individually and in combination) would not have a material impact on the overall risk estimates. Appropriate minimum loss thresholds for internal loss data collection shall be defined.

(4) The bank shall keep a database on the minimum features of each operational event, as per Table 3 of Appendix 10 *Operational Risk*. The bank may also collect additional information at its own discretion.

(5) The bank shall apply specific criteria for assigning loss data arising from an event in a centralised function or an activity that spans more than one business line, as well as from related events over time.

(6) The bank shall have documented procedures for assessing the on-going relevance of historical loss data, including those situations in which judgement overrides, scaling, or other adjustments may be used, to what extent they may be used and who is authorised to make such decisions.

External Data

Article 329. (1) The bank's operational risk measurement system shall use relevant external data, especially when there is reason to believe that the bank is exposed to infrequent, yet potentially severe losses.

(2) The bank shall have a systematic process for determining the situations for which external data must be used and the methodology used to process the data.

(3) The conditions and practices for external data use shall be documented and shall be subject to periodic independent review.

Scenario Analysis

Article 330. The bank shall use scenario analysis of expert opinion in conjunction with external data to evaluate its exposure to high severity events. In these cases it shall rely on the expertise of risk management experts. Such assessments shall be regularly validated and re-assessed through comparison to actual loss experience to ensure their reasonableness and accuracy.

Business Environment Factors and Internal Control Mechanisms

Article 331. (1) The bank's operational risk assessment methodology shall capture key business environment and internal control factors that can change its operational risk profile.

(2) The factors under paragraph 1 may be defined as a meaningful driver of risk to the affected business areas and its choice shall be based on experience and involving an expert judgment.

(3) The sensitivity of risk estimates to changes in the factors and the relative weighting of the various factors shall be well reasoned. In addition to capturing changes in risk due to improvements in risk controls, the bank's system shall also capture potential increases in risk due to greater complexity of activities or increased business volume.

(4) The used framework shall be documented and subject to independent review within the bank and by the Bulgarian National Bank. Over time, the process and the outcomes shall be validated and re-assessed through comparison to actual internal loss experience and relevant external data.

Risk Reduction by Means of Insurance and Other Risk Transfer Mechanisms

Article 332. (1) In using advanced measurement approaches for operational risk, the bank may recognise the risk mitigating effect of insurance contracts subject to the following conditions:

1. the insurer is authorised to provide insurance or re-insurance;
2. the insurer has a minimum claims paying ability rating by an eligible ECAI which corresponds to credit quality step 3 or above under the Standardised Approach for credit risk;
3. the insurance policy must have an initial term of no less than one year. For policies with a residual term of less than one year, the bank must make appropriate haircuts reflecting the declining residual term of the policy. For policies with a residual term of under one year, the bank shall calculate haircuts under a straight-line method, from 0% for policies with a residual term of 365 days to 100% for policies with a residual term of 90 days;

4. the insurance policy has a minimum notice period for cancellation of the contract of 90 days; and when the period for cancellation of the policy is under one year, this term shall be the residual term of the policy;

5. the insurance policy has no exclusions or limitations triggered by supervisory actions or, in the case of a failed bank, that preclude the bank, receiver or liquidator, from recovering for damages suffered or expenses incurred by the bank, except in respect of events occurring after the initiation of receivership or liquidation proceedings in respect of the bank; the insurance policy coverage may exclude any fine, penalty, or punitive damages resulting from actions by the BNB;

6. the risk mitigation calculations must reflect the insurance coverage in a manner that is transparent in its relationship to, and consistent with, the actual likelihood and impact of loss used in the overall determination of operational risk capital;

7. the insurance is provided by a third party entity; in the case of insurance through subsidiaries and affiliates, the exposure has to be laid off to an independent third party entity, for example through re-insurance, that meets the eligibility criteria;

8. the framework for recognising insurance is well reasoned and documented;

9. the bank shall disclose the manner in which it uses insurance for operational risk mitigation purposes.

(2) The bank's methodology for recognising insurance shall capture, through discounts or haircuts in the amount of insurance recognition, the uncertainty of payment as well as mismatches in coverage of insurance policies.

(3) The bank shall be able to recognise a risk mitigation impact of other risk transfer mechanisms where the bank can demonstrate to the satisfaction of the BNB that a noticeable risk mitigating effect is achieved.

(4) (amended; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) The capital alleviation arising from the recognition of insurance and other risk transfer mechanisms shall not exceed 20% of the capital requirement for operational risk before the recognition of risk mitigation techniques.

Section Four

COMBINED USE OF DIFFERENT APPROACHES

Combined Use of the Basic Indicator Approach and the Standardised Approach

Article 333. (1) A bank may use a combination of the Basic Indicator Approach and the Standardised Approach only in cases which may require a transition period for the roll out of the Standardised Approach for new businesses or structures.

(2) The combined use of the Basic Indicator Approach and the Standardised Approach shall be permitted within a time schedule agreed with the BNB for the roll-out of the Standardised Approach for the other activities.

Use of Advanced Measurement Approaches in Combination with Other Approaches

Article 334. (1) A bank may use an Advanced Measurement Approach in combination with either the Basic Indicator Approach or the Standardised Approach, subject to the following conditions:

1. all operational risks of the bank are captured; the used methodology covers the different activities, geographical locations, legal structures or other relevant divisions determined on an internal basis;

2. the qualifying criteria for the use of the Standardised Approach and of the Advanced Measurement Approaches respectively are fulfilled for the activities covered by these approaches.

(2) A combined use shall not be permitted in the cases where the bank wants to apply the Basic Indicator Approach or the Standardised Approach to one core and significant business line and to apply the Advanced Measurement Approach to another core and significant business line.

(3) On a case-by-case basis, the BNB may impose the following additional conditions:

1. on the date of implementation of an Advanced Measurement Approach, a significant part of the bank's operational risks are captured by the Advanced Measurement Approach;

2. the bank takes a commitment to roll out the Advanced Measurement Approach across a material part of its operations within a time schedule agreed with the BNB.

PART FIVE

DISCLOSURE REQUIREMENTS

Chapter Eighteen

Section One

TECHNICAL CRITERIA ON DISCLOSURE

General Provision

Article 335. (1) Each bank shall publicly disclose in Bulgarian language information at least on the following:

1. scope and methods of consolidation;
2. risk management policies and rules;
3. structure and elements of the capital base;
4. capital requirements;
5. exposure to counterparty credit risk;
6. exposure to credit risk and dilution risk;

7. information on the nominated ECAIs and ECAs in applying the Standardised Approach for credit risk;

8. in applying Article 63, paragraph 7 and Article 66 for the Internal Ratings Based Approach – information on the exposures broken down by category and risk weighting;

9. (amended; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) capital requirement for position risk for the instruments in the trading book, as well as foreign exchange risk, commodity risk and settlement risk for the overall business; in addition to disclosure under item 14, the capital requirement for specific position risk risk of securitisation positions shall be disclosed separately;

10. internal models for market risk;

11. exposure to operational risk;

12. equity instruments in the banking book;

13. interest rate risk in the banking book;

14. (amended; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) securitisation, separately for banking and non-banking book;

15. recognition for supervisory purposes of the internal models and credit risk mitigation techniques;

16. (new; Darjaven Vestnik, issue 102 of 2010, effective as of 1 January 2011) remuneration policy and practices for the staff categories under Article 2 of BNB Ordinance No. 4 of 2010 on the Requirements for Remunerations in Banks.

(2) (amended; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) Each bank shall adopt formal rules to comply with the disclosure requirements, and shall have policies for assessing the appropriateness of its disclosures, including their verification and frequency. Each bank shall also have policies for assessing whether its disclosures convey its risk profile comprehensively to market participants.

(3) (new; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011.) Where those disclosures do not comply with the requirements under paragraph 2, the bank shall publicly disclose the information necessary pursuant paragraphs 6 – 10 in addition to that required under paragraph 1.

(4) (former paragraph 3; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) Each bank shall determine the appropriate medium, location and means of verification to comply effectively with the disclosure requirements laid down in this article. The information shall be provided on the bank's official Internet site and in at least one medium or location in a manner that allows reading on a screen or on paper.

(5) (former paragraph 4; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) Equivalent disclosures made by a bank under accounting, legal or other requirements may be deemed to constitute compliance with this Part. If disclosures are not included in the financial statements, the bank shall indicate where they can be found, and the manner in which it has verified the information.

(6) (former paragraph 5; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) A bank may omit one or more of the disclosures required if the information provided by such disclosures is not regarded as material. Information shall be regarded as material in disclosures if its omission or misstatement could change or influence the assessment or decision of a user relying on that information for the purpose of making economic decisions.

(7) (former paragraph 6; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) A bank may omit one or more items of the information included in the disclosures required if those items would include information which is regarded as proprietary or confidential.

(8) (former paragraph 7; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) Information shall be regarded as proprietary to a bank if sharing that information with the public would undermine its competitive position. It may include information on products or systems which, if shared with competitors, would render the bank's investments wherein less valuable.

(9) (former paragraph 8; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) Information shall be regarded as confidential if there are obligations to customers or other counterparty relationships binding a bank not to disclose information regarding them.

(10) (former paragraph 9; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) A bank shall state in its disclosures the fact that specific items of information are not disclosed under paragraph 6 and the reason for not-disclosure.

(11) (former paragraph 10; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) The bank shall publish more general information about the subject matter of the disclosed information.

(12) (new; Darjaven Vestnik, issue 102 of 2010, effective as of 1 January 2011; former paragraph 11; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) Banks shall comply with the requirements under paragraph 1, item 16 in a manner that is appropriate to their size, internal organization, the nature, scope and complexity of their activities.

(13) (new; Darjaven Vestnik, issue 102 of 2010, effective as of 1 January 2011; former paragraph 12; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) Banks shall disclose quantitative information referred to in paragraph 1, item 16 related to the persons under Article 10 of the Law on Credit Institutions.

(14) (new; Darjaven Vestnik, issue 102 of 2010, effective as of 1 January 2011; former paragraph 13; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011) The Bulgarian National Bank shall use the information collected in accordance with the criteria for disclosure established in item 6 of List 15 of Appendix 11 *Disclosures* to benchmark remuneration trends and practices. The Bulgarian National Bank shall provide the European Banking Authority with this information.

Frequency and Time Limits of Disclosure

Article 336. (1) Each bank shall publish the disclosures required under Article 335, paragraph 1 and Article 339 on a yearly basis.

(2) A bank shall also determine whether more frequent publication than is provided for in paragraph 1 is necessary in the light of the relevant characteristics of its business:

1. scale of operation, range of activities;
2. presence in different countries;
3. involvement in different financial markets;
4. participation in international financial markets;
5. participation in payment, settlement and clearing systems.

(3) In assessing the need under paragraph 2, the bank shall pay particular attention to the following items of disclosure:

1. (amended; Darjaven Vestnik, issue 38 of 2008, effective as of 11 April 2008) the items of tier-one capital after the deductions under Article 3, paragraph 6;
2. the items of the capital base after the deductions under Article 6;
3. the risk weighted assets of a bank using Standardised Approach for credit risk for the exposure classes under Article 24;
4. the items of the operational risk capital requirements.

(4) The information under Article 335, paragraphs 1 and 2 shall be disclosed on quarterly basis after the end of the relevant period. The BNB shall be informed about the disclosures made. When the disclosure is on a consolidated basis, the period is six months.

Special Case of Disclosure

Article 337. (1) Each bank should, if requested, explain in writing its rating decision to a small, medium-sized or other corporates.

(2) Should the fulfillment of the obligation under paragraph 1 by a bank proves inadequate, the BNB may impose additional requirements on that bank.

(3) The fee for processing the request under paragraph 1 has to be at an appropriate rate the size of the loan applied for.

Chapter Nineteen

DISCLOSURE ELEMENTS

Article 338. (1) Under Article 335, paragraph 1, item 1, the bank shall disclose the information specified in List 1 of Appendix 11 *Disclosures*.

(2) Under Article 335, paragraph 1, item 2, the bank shall disclose the information specified in List 2 of Appendix 11 *Disclosures*.

(3) Under Article 335, paragraph 1, item 3 the bank shall disclose the information specified in List 3 of Appendix 11 *Disclosures*.

(4) Under Article 335, paragraph 1, item 4 the bank shall disclose the information specified in List 4 of Appendix 11 *Disclosures*.

(5) Under Article 335, paragraph 1, item 5 the bank shall disclose the information specified in List 5 of Appendix 11 *Disclosures*.

(6) Under Article 335, paragraph 1, item 6 the bank shall disclose the information specified in List 6 of Appendix 11 *Disclosures*. The value adjustments and the recoveries recorded directly to the income statement shall be disclosed separately.

(7) Under Article 335, paragraph 1, item 7 the bank shall disclose the information specified in List 7 of Appendix 11 *Disclosures*.

(8) Under Article 335, paragraph 1, item 10 the bank shall disclose the information specified in List 8 of Appendix 11 *Disclosures*.

(9) Under Article 335, paragraph 1, item 11, the bank shall disclose the information specified in List 9 of Appendix 11 *Disclosures*.

(10) Under Article 335, paragraph 1, item 12, the bank shall disclose the information specified in List 10 of Appendix 11 *Disclosures*.

(11) Under Article 335, paragraph 1, item 13, the bank shall disclose the information specified in List 11 of Appendix 11 *Disclosures*.

(12) Under Article 335, paragraph 1, item 14, the bank shall disclose the information specified in List 12 of Appendix 11 *Disclosures*.

(13) (new; Darjaven Vestnik, issue 102 of 2010, effective as of 1 January 2011) Under Article 335, paragraph 1, item 16, the bank shall disclose the information specified in List 15 of Appendix 11 *Disclosures.*

Chapter Twenty

REQUIREMENTS FOR THE USE OF PARTICULAR INSTRUMENTS OR METHODOLOGIES

Article 339. (1) A bank using the Internet Rating Based Approach shall disclose the information specified in List 13 of Appendix 11 *Disclosures*.

(2) A bank applying credit risk mitigation techniques shall disclose the information specified in List 14 of Appendix 11 *Disclosures*.

(3) (amended; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) A bank using an Advanced Measurement Approach for operational risk shall disclose a description of the use of insurance policies and other risk transfer mechanisms for the purpose of mitigating the operational risk.

PART SIX

CAPITAL ADEQUACY REPORTING. ADMINISTRATIVE ARRANGEMENTS

Chapter Twenty One

CAPITAL ADEQUACY REPORTING – GENERAL PROVISIONS

Capital Adequacy Reports

Article 340. (1) Banks shall prepare a capital adequacy report on the basis of the balance sheet at the last day of each quarter. This report shall be submitted to the BNB Banking Supervision Department by the 15th day of the month following the reporting period.

(2) The parent bank shall prepare and submit to the BNB Banking Supervision Department a consolidated capital adequacy report twice a year in accordance with this Ordinance and Ordinance No. 12 on the Supervision on a Consolidated Basis.

(3) The Deputy Governor in charge of the BNB Banking Supervision Department shall give mandatory instructions about the preparation and submission of the capital adequacy report.

Additional Information

Article 341. The Deputy Governor in charge of the BNB Banking Supervision Department may require that banks provide additional information on each item in the capital adequacy report.

Chapter Twenty Two

ADJUSTMENT OF THE OWN FUNDS AND CONTROL OF DATA ACCURACY

Adjustment of Capital

Article 342. (1) If a bank finds out that it does not meet the requirements under Articles 7 and 22, it shall immediately notify thereof the Deputy Governor in charge of the BNB Banking Supervision Department and shall also suggest a rehabilitation programme with time limits for bringing the capital adequacy ratios in compliance with the Law on Credit Institutions and this Ordinance. This programme shall be approved by the Deputy Governor in charge of the BNB Banking Supervision Department.

(2) If the approved programme under paragraph 1 is not fulfilled, the BNB shall impose the measures and penalties under the Law on Credit Institutions.

(3) While implementing the programme under paragraph 1, the bank may not pay any dividends.

Ban on the Distribution of Profits Whereby Capital Adequacy Requirements are in Breach

Article 343. Banks may not distribute, in the form of dividends or other forms of capital distribution, the profits which have been included, as prescribed in this Ordinance, as an element of their own funds and when they are in breach of the requirements of this Ordinance.

Control of Data Accuracy

Article 344. (1) The banking supervisory authorities shall check the accuracy of, and the compliance with the rules for the determination of, the overall risk component, including by on-site examinations and comparison of the report data with the banks' accounting and operational reports.

(2) The examiners under Article 76 of the Law on Credit Institutions shall carry out an examination and shall state in their report and give their conclusions on:

1. whether the risk of individual items is correctly reported in terms of determining the actual capital adequacy;

2. the status of banks' reporting and the assessment of their positions in compliance with the laws and regulations.

(3) The examiners' conclusion shall in all cases include an assessment of banks' risk exposures and capital adequacy.

Chapter Twenty Three

ADMINISTRATIVE ARRANGEMENTS AND SUPERVISORY FEES

Article 345. (1) The permissions, approvals and other resolutions of BNB under this Ordinance are issued from the BNB Deputy Governor in charge of the Banking Supervision Department or by officials authorised by him/her, based on application, accompanied with the required documents and other materials.

(2) In the procedure of considering the application, BNB can request form the applicant the submission in certain period additional information and documents for clarifying all circumstances for making assessment whether there are conditions for granting an approval or denial.

(3) BNB can express an opinion on the application in 3 months period as of its receipt accompanied with all the required documents, unless provided other period in this Ordinance.

(4) BNB can revoke issued permission or approval under this Ordinance if:

1. is ascertained that the applicant has submitted incorrect or misleading information;

2. is ascertained that there are changes in the circumstances and prerequisites, on which the permission is based;

3. the applicant ceases to meet the requirements of this Ordinance, connected with the issuance of the permission.

(5) In the procedure of consideration of the applications under this Ordinance, BNB can gather all evidence, eligible under the Administrative Procedure Code, and also can perform onside examinations.

Administrative Fees

Article 346. In order to cover the administrative expenses for the examination of the applications and documents for permits to be issued under this Ordinance, the BNB shall charge fees as follows:

1. (amended; Darjaven Vestnik, issue 38 of 2008; effective as of 11 April 2008; amended; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) under Article 3a, paragraph 7 and Article 4, paragraph 5 – BGN 1000;

2. (amended; Darjaven Vestnik, issue 38 of 2008; effective as of 11 April 2008) under Article 262, paragraph 1 – BGN 5000.

3. (repealed; Darjaven Vestnik, issue 38 of 2008; effective as of 11 April 2008)

ADDITIONAL PROVISIONS

§ 1. For the purposes of this Ordinance:

1. "*Warrant*" means a security which gives its holder the right to purchase the underlying instrument at a stipulated price until or at the expiry date of the warrant and which may be settled by the delivery of the underlying instrument or by cash settlement.

2. *„Probability of Default"* means the probability of default of a counterparty over a one year period under a current or future transaction.

3. *„Two-way Market"* means a situation where there are independent good faith offers to buy and sell so that a price reasonably related to the last sales price or current good faith competitive bid and offer quotations can be determined within one day and settled at such a price within a relatively short time conforming to trade custom.

4. *„Loss"* means economic loss, including material discount effects, and material direct and indirect costs associated with collecting on the instrument.

5. *„Loss Given Default (LGD)"* means the ratio of the loss on an exposure due to the default of a counterparty to the amount outstanding at default.

6. *"Solicited Credit Assessment"* means an assessment assigned by an ECAI after preliminary request from the party, to which the credit assessment is assigned.

7. *"Over-the-counter Derivative Instruments"* means contracts which are not traded on a recognised exchange where they would be subject to daily requirements for an additional margin.

8. *"Institutions"* means credit institutions and investment firms.

9. „*Qualifying Positions*" means:

a) long and short positions in assets qualifying for a credit quality step under the standardised approach, corresponding at least to investment grade;

b) long and short positions in assets which, because of the solvency of the issuer, have a PD under the internal ratings based approach which is not higher than that of the assets referred to under (a);

c) long and short positions in assets for which a credit assessment by a nominated ECAI is not available and which: are considered to be sufficiently liquid; their credit quality is, according to the bank's own discretion, at least equivalent to that of the assets referred to in (a) and are listed on at least one regulated market in a Member State or on a stock exchange in a third country provided that the exchange is recognised by the BNB;

d) long and short positions in assets issued by EU institutions subject to capital adequacy requirements equivalent to those set out in this Ordinance; which are considered by the bank to be sufficiently liquid; and whose credit quality is, according to the bank's own discretion, at least equivalent to that of the assets referred to in (a);

e) securities, issued by the institutions, that are deemed to be subject to capital adequacy requirements equivalent to those set out in this Ordinance, and having second or higher credit quality under the standardised approach for credit risk.

10. *„Conversion Factor"* means the ratio of the currently undrawn amount of a commitment that will be drawn and outstanding at default to the total currently undrawn amount of the commitment. The extent of the commitment shall be determined by the agreed limit, unless the bank's internal limit is higher.

11. *"Convertible Security"* means a security which, at the option of the holder, may be exchanged for another security.

12. (amended; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) "*Minimum Lease Payments*" means the payments over the lease term that the lessee is or can be required to make in favour of the bank and any bargain option (i.e. option the exercise of which is reasonably certain).

13. *"Multilateral Trading Facility"* means a multilateral system operated by an investment firm or a market operator, which brings together multiple third party buying and selling interests in financial instruments – in the system and in accordance with non-discretionary rules – in a way that results in a contract.

14. "*Covered Bonds"* shall mean bonds, which:

a) are issued by a credit institution, established in Member State;

b) are covered with assets, which are acquired with funds, raised from the covered bonds emission and throughout the whole term of the emission they act as preferable indemnification of the claims of the bondholders, including the cases of issuer insolvency; and

c) which are subject to special protection of the interest of the bondholders by a special legal framework.

15. *„Expected Loss (EL)"* shall mean the ratio of the amount expected to be lost on an exposure from a potential default of a counterparty or dilution over a one year period to the amount outstanding at default.

16. „*Securities or Commodities Lending*" and „*Securities or Commodities Borrowing*" mean any transaction in which there is a transfer of securities or commodities against appropriate collateral. The borrower makes the commitment to return equivalent securities or commodities at some future date or when requested to do so by the transferor. The transaction is securities or commodities lending for the party transferring the securities or commodities, and is securities or commodities borrowing for the party to which they are transferred.

17. *"Cumulative Preferential Shares"* means a type of preferential share under which the non-payment of a dividend for a certain year creates an obligation for the issuer to pay a dividend for that year together with the next payment of a dividend.

18. „*Recognised Exchanges*" means exchanges that meet the following requirements:

a) they function regularly;

b) they have rules, issued or approved by the respective competent authorities of the home country of the exchange, and these rules define the conditions for the operation of the exchange and the conditions of access to the exchange, as well as the conditions that shall be satisfied by a contract before it can effectively be dealt on the exchange;

c) they have a clearing mechanism whereby contracts listed in Appendix 1 *List of Derivatives* are subject to daily margin requirements which, in the opinion of the competent authorities, provide adequate protection.

19. „*Repurchase Agreement*" and „*Reverse Repurchase Agreement*" mean any agreement in which there is a transfer of securities or commodities or guaranteed rights relating to title to securities or commodities, subject to a commitment to repurchase them (or substituted securities or commodities of the same description) at a specified price on a future date specified or to be specified by the transferor. The agreement must not allow the transferor to transfer or pledge a particular security or commodity to more than one counterparty at one time. This agreement is a repurchase agreement for the party selling the securities or commodities, and is a reverse repurchase agreement for the party buying them.

20. "*Regulated Market*" means an authorised multilateral system operated and/or managed by a market operator who combines or facilitates the demand for, and supply of, financial instruments by third parties in a manner that leads to contracts on the financial instruments traded by its rules.

21. „*RUF (Revolving Underwriting Facility)*" means a credit transaction, a version of NIF, where not one bank but a group of banks intermediates in the issuance of securities by a customer, and usually the group provides a limit up to the full amount of the issue, up to which limit it agrees to buy back the securities issued by

the customer in case such securities have not been sold and the amount that has not been sold in the public subscription.

22. *„Dilution Risk"* means the risk that an amount receivable is reduced through a cash or non-cash obligation to the obligor.

23. „*Free Delivery*" means a transaction where it has been agreed that the Delivery Versus Payment (DVP) principle will not be met.

24. *"Stock Financing"* means positions where physical stock has been sold forward and the cost of funding has been locked in until the date of the forward sale;

25. „*Matched Position*" means the smaller of the short position and the long position in a maturity band or in the specified currencies and the unmatched position means the difference between the two.

26. „*NIF (Note Issuance Facility)*" means a credit transaction related to the issuance of securities by a customer, with the intermediation and under the management of a bank, under which transaction the bank provides the customer with a certain limit up to which it agrees to buy back the securities issued by the customer under this transaction.

27. "*Financial Instrument*" means any contract that gives rise to both a financial asset of one party and a financial liability or equity instrument of another party.

28. „*Hedging*" means a risk reduction method by making transactions in a way that allows the risk of the transactions made to be avoided or reduced to the minimum against payment at the agreed hedging price.

§ 2. For the purposes of Chapter Six *Credit Risk Mitigation* of Part Two:

1. *"Type of Security"* means securities which are issued by the same entity, have the same issue date, the same maturity and are subject to the same liquidation periods under the Financial Collateral Comprehensive Method.

2. *"Unfunded Credit Protection"* is a technique of credit risk mitigation where the reduction of the credit risk on the exposure of a bank derives from the undertaking of a third party to pay an amount in the event of the default of the borrower or on the occurrence of other specified credit events.

3. *"Volatility Adjustment"* means an adjustment in the value of an exposure and its collateral, reflecting the volatility of the price and the exchange rate.

4. *"Lending Institution"* is the credit institution that has an exposure as a result of a loan granted or in another way.

5. *"Credit Event"* means an event defined in a credit derivative contract, the occurrence of which triggers a payment under the contract.

6. *"Internal Model Method"* is a method by which volatility adjustments are calculated on the basis of an internal model which takes account of the correlations between the positions in securities being subject of a master netting agreement and the liquidity of the instruments.

7. *"Supervisory Volatility Adjustments"* is an approach under which volatility adjustments are pre-defined by the BNB.

8. *"Independent Valuer"* shall mean a person who possesses the necessary qualifications, ability and experience to execute a valuation and who is independent from the credit decision process.

9. *"Net Adjusted Exposure Value"* means the value of exposure after recognising the risk reduction by means of collateral and after making a volatility adjustment.

10. *„Funded Credit Protection"* means a technique of credit risk mitigation where the reduction of the credit risk on the exposure of a bank derives from the right of the institution – 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.

11. "*Secured Lending Transaction*" shall mean any transaction secured by collateral other than a margin.

12. *"Core Market Participants"* means:

a) the entities under Article 135, item 2, the exposures to which are assigned 0% risk weight under the standardised approach;

b) institutions;

c) financial institutions and insurance companies, the exposures to which are assigned 20% risk weight under the standardised approach;

d) other financial institutions and insurance companies that have not been rated by an external credit assessment institution but have been rated by a bank by the internal ratings based approach, which rating corresponds to credit quality step 2 or better under the standardised approach;

e) collective investment undertakings (CIUs) that are subject to supervision and capital adequacy or leverage requirements (own funds / attracted funds);

f) pension funds that are subject to supervision;

g) recognised clearing organisations.

13. *"Liquidation Period"* means the number of days for which prices are monitored in accordance with the type of transaction so as to determine its volatility adjustment.

14. "*Capital Market-driven Transaction*" shall mean any transaction, other than a repurchase agreement, giving rise to an exposure secured by collateral which includes a provision conferring upon the bank the right to receive margin frequently.

15. *"Own Estimates of Volatility Adjustments"* is an approach under which the bank itself defines the volatility adjustments.

16. *"Market Value"* means the estimated amount for which the property should exchange on the date of valuation between a willing buyer and a willing seller in an arm's-length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion.

17. *„Credit Risk Mitigation"* means a technique used by a bank to reduce the credit risk associated with an exposure or exposures which the institution continues to hold.

18. *"Cash Assimilated Instrument"* means a certificate of deposit or other similar instrument issued by the lending credit institution.

§ 3. For the purposes of Chapter Seven *Securitisation Framework* of Part Two:

1. "*Sponsor Bank"* means a bank other than an originator institution that establishes and manages an asset-backed commercial paper programme or other securitisation scheme that purchases exposures from third parties.

2. "*Excess Spread*" means the charge collections and other fee income received in respect of the securitised exposures net of costs and expenses.

3. *"Securitisation Special Purpose Entity (SSPE)"* means a corporation trust or other entity, other than a credit institution, organised for carrying on a securitisation or securitisations, and for which the following is met:

a) the activities of the SSPE are limited to those appropriate to accomplishing that objective;

b) the structure of the SSPE is intended to isolate the obligations of the SSPE from those of the originator credit institution;

c) the holders of the instruments issued by the SSPE have the right to pledge or exchange those instruments without restriction.

4. *"Originator"* means an institution which, directly or indirectly, is involved in the agreement which creates the obligations of the debtor giving rise to the exposure being securitised.

5. "K_{irb}" means 8% of the risk weighted exposure amounts calculated under the internal ratings based approach in respect of the securitised exposures, plus the amount of expected losses associated with those exposures calculated under the same approach.

6. *"Credit Enhancement"* means a contractual agreement to cover loss on securitised exposures whereby the credit quality of a securitisation tranche is improved, including the enhancement provided by more junior tranches, credit derivatives, spread accounts, subordinated debt, and protection provided through subordinated tranches.

7. *"Liquidity Facility"* means the securitisation position arising from a contractual agreement to provide funding to ensure timeliness of cash flows to investors.

8. *"Trapping Point of the Excess Spread"* is the level of the excess spread above which the bank is required to start trapping the excess spread with the purpose of protection of the investors according to the conditions of the contract.

9. "*Servicer*" means an entity responsible for the day-to-day management of securitised exposures, for collecting the principal and interest due, and for transferring them to the investors.

10. "*Clean-up Call Option*" means a contractual option for the originator to repurchase or extinguish the securitisation positions before all of the underlying ex-

posures have been repaid, when the amount of outstanding exposures falls below a specified level.

11. "*Asset-backed Commercial Paper Programme"* (ABCP) means a programme of securitisation of commercial receivables by issuing commercial papers with an original maturity of one year or less.

12. "*Rated Position*" means a securitisation position which has an eligible credit assessment by an eligible ECAI.

13. "*Securitisation"* means a transaction or scheme, whereby the credit risk associated with the underlying exposure or pool of exposures is tranched, having the following characteristics:

a) cash flows on the transaction or scheme are dependent upon the performance of the underlying exposure or pool of exposures; and

b) the subordination of tranches determines the distribution of losses during the ongoing life of the transaction or scheme.

14. "*Securitisation Position"* means an exposure to a securitisation scheme, including exposures arising from interest-rate or exchange-rate derivatives.

15. *"Synthetic Securitisation"* means a securitisation where the tranching is achieved by the use of credit derivatives or guarantees, and the pool of exposures is not removed from the balance sheet of the originator credit institution.

16. "*General Market Disruption"* means a situation where more than one SPE across different transactions are unable to roll over maturing commercial paper and that inability is not the result of an impairment of the SPE's credit quality or of the credit quality of the securitised exposures.

17. *"Traditional Securitisation'* means a securitisation scheme involving the economic transfer of the exposures being securitised to a securitisation special purpose entity which issues securities under the following conditions:

a) the originator bank shall transfer ownership of the securitised exposures or through sub-participation;

b) the securities issued do not represent payment obligations of the originator credit institution.

18. "*Tranche"* means a contractually established segment of the credit risk of securitised exposures, which entails a level of credit risk different from the risk of the other segments of the securitisation scheme, and the credit risk level shall be determined without taking account of credit protection provided by third parties directly to the holders of positions in the segment or in other segments.

19. (new; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) *"Retention of Net Economic Interest"* means at least one of the following requirements to be met:

a) retention of no less than 5% of the nominal value of each of the tranches sold or transferred to the investors;

b) in the case of securitisations of revolving exposures, retention of the originator's interest of no less than 5% of the nominal value of the securitised exposures;

c) retention of randomly selected exposures, equivalent to no less than 5% of the nominal amount of the securitised exposures, where such exposures would otherwise have been securitised in the securitisation, provided that the number of potentially securitised exposures is no less than 100 at origination; or

d) retention of the first loss tranche and, if necessary, other tranches having the same or a more severe risk profile than those transferred or sold to investors and not maturing any earlier than those transferred or sold to investors, so that the retention equals in total no less than 5% of the nominal value of the securitised exposures.

20. (new; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) *"Mezzanine tranche"* in the securitisation scheme means securitisation positions to which a risk weight lower than 350% applies and that are more junior than the most senior position in this securitisation and more junior than any securitisation position in this securitisation to which:

a) in the case of calculation procedures under Articles 202 – 214, a credit quality step 1 is assigned;

b) in the case of calculation procedures under Articles 215 – 230, a credit quality step 1 or 2 is assigned.

21. (new; Darjaven Vestnik, issue 95 of 2001, effective as of 31 December 2011) "Re-securitisation" means a securitisation where the risk associated with an underlying pool of exposures is tranched and at least one of the underlying exposures is a securitisation position.

22. (new; Darjaven Vestnik, issue 95 of 2001, effective as of 31 December 2011) "Re-securitisation position" means an exposure to a re-securitisation.

§ 4. For the purposes of Chapter Eight *Treatment of Counterparty Risk* of Part Two:

1. "*Peak Exposure*" means a high percentile of the distribution of exposures at any particular future date before the maturity date of the longest transaction in the netting set. Percentile is the lowest figure under which a certain percentage of empirical or theoretical distribution values fall.

2. "*Actual Distribution*" means a distribution of market values or exposures at a future time period on the basis of dynamic series of data.

3. "*One-sided Credit Valuation Adjustment*" means a credit valuation adjustment that reflects the market value of the credit risk of the counterparty to the bank, but does not reflect the market value of the credit risk of the bank to the counterparty.

4. "*Effective Maturity"* under the internal model method, for a netting set with maturity greater than one year means the ratio of the sum of expected exposure over the life of the transactions in the netting set discounted at the risk-free rate of return divided by the sum of expected exposure over one year in a netting set discounted at the risk-free rate. This effective maturity may be adjusted to reflect rollover risk by replacing expected exposure with effective expected exposure for forecasting horizons under one year.

5. “*Effective Expected Exposure (Effective EE)*” at a specific date means the maximum expected exposure that occurs at that date or any prior date.

6. “*Effective Expected Positive Exposure (Effective EPE*)” means the weighted average over time of effective expected exposure over the first year, or, if all the contracts within the netting set mature within less than one year, over the time period of the longest maturity contract in the netting set, where the weights are the proportion that an individual expected exposure represents of the entire time interval.

7. *“Ageing of Exposure”* means the correlation between the risk characteristics of the exposure and its movements towards maturity.

8. “*Credit Valuation Adjustment*” means an adjustment to the mid-market valuation of the portfolio of transactions with counterparty. This adjustment reflects the market value of the credit risk due to any failure to perform on contractual agreements with counterparty. This adjustment may reflect the market value of the credit risk of the counterparty or the market value of the credit risk of both the bank and the counterparty.

9. “*Cross-product Netting*” means the inclusion of transactions of different product categories within the same netting set.

10. “*Margin Lending Transactions*” mean transactions 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 happen to be secured by securities collateral.

11. “*Margin Threshold*” means the largest amount of an exposure that remains outstanding until one party has the right to call for collateral.

12. “*Margin Period of Risk*” means the time period from the last exchange of collateral covering netting set of transactions with a defaulting counterparty until the exposure to that counterparty is closed out and the resulting market risk is re-hedged.

13. “*Margin Agreement*” means a contractual agreement or provisions of an agreement under which one counterparty shall supply collateral to a second counterparty when an exposure of that second counterparty to the first counterparty exceeds a specified level.

14. (amended; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) “*Netting Set*” means a group of transactions with a single counterparty that are subject to a legally enforceable bilateral netting arrangement and for which netting is recognised under Articles 259 – 260 and Chapter Four of Part Six *Credit Risk Mitigation*. Each transaction that is not subject to a legally enforceable bilateral netting arrangement should be interpreted as its own netting set for the purpose of Chapter Eight of Part Two *Treatment of Counterparty Risk.* Under the internal model method, all netting sets with a single counterparty may be treated as a single netting set if negative simulated market values of the individual netting sets are set to 0 in the estimation of the expected exposure.

15. “*General Wrong-way Risk*” arises when the probability of default (PD) of counterparty is positively correlated with general market risk factors.

16. “*Expected Exposure (EE)*” means the average of the distribution of exposures at any particular future date before the longest maturity transaction in the netting set matures.

17. “*Expected Positive Exposure (EPE)*” means the weighted average over time of expected exposures where the weights are the proportion that an individual expected exposure represents of the entire time interval. When calculating the minimum capital requirement, the average is taken over the first year or, if all the contracts within the netting set mature within less than one year, over the time period of the longest maturity contract in the netting set.

18. *“Potential Future Exposure”* means the maximum exposure at a particular future date that is generated at a high level of confidence.

19. “*Distribution of Exposures*” means the forecast of the probability distribution of market values that is generated by setting forecast instances of negative net market values equal to zero.

20. “*Distribution of Market Values*” means the forecast of the probability distribution of net market values of transactions within a netting set for some future date (the forecasting horizon), given the realised market value of those transactions up to the present time.

21. *„Rollover Risk”* means the amount by which expected positive exposure is understated when future transactions with a counterparty are expected to be conducted on an ongoing basis. The additional exposure generated by those future transactions is not included in calculation of the expected positive exposure.

22. “*Risk-neutral Distribution*” means a distribution of market values or exposures at a future time period where the distribution is calculated using market implied values such as implied volatilities.

23. *„Risk Position”* means a risk number that is assigned to a transaction under the Standardised Method for counterparty risk, following a predetermined algorithm.

24. “*Specific Wrong-way Risk*” arises when the exposure to a particular counterparty is positively correlated with the PD of the counterparty due to the nature of the transactions with the counterparty and the amount of exposure to 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 PD is also high.

25. *„Current Exposure”* means the positive market value of transactions within a netting set with a counterparty that would be lost upon the default of the counterparty, assuming no recovery on the value of those transactions in bankruptcy.

26. “*Current Market Value (CMV)*” means the net market value of the portfolio of transactions within the netting set with the counterparty.

27. “*Long Settlement Transactions*” mean 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 that is contractually specified as more than the lower of the market

standard for this particular transaction and five business days after the date on which the bank enters into the transaction.

28. “*Hedging Set*” means a group of risk positions from the transactions within a single netting set for which only their balance is relevant for determining the exposure value under the Standardised Method.

29. *„Central Counterparty”* means an entity that legally interposes itself between counterparties to contracts traded within one or more financial markets, becoming the buyer to every seller and the seller to every buyer.

§ 5. The BNB functions under this Ordinance shall be performed by the BNB Deputy Governor in charge of the Banking Supervision Department or by officials authorised by him/her.

§ 5a. (new; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) Documents required for granting approvals under Articles 3a, 4 and 260, shall be submitted to the BNB with a certified translation in Bulgarian language, in case they are drafted in foreign language. In any discrepancies between the texts, the Bulgarian one shall be authentic.

§ 5b. (new; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010; amended Darjaven Vestnik, issue 102 of 2010, effective as of 1 January 2011) This Ordinance shall introduce the requirements of:

Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast);

Directive 2006/49/EC of the European Parliament and of the Council of 14 June 2006 on the capital adequacy of investment firms and credit institutions (recast);

Commission Directive 2007/18/EC of 27 March 2007 amending Directive 2006/48/EC of the European Parliament and of the Council as regards the exclusion or inclusion of certain institutions from its scope of application and the treatment of exposures to multilateral development banks;

Directive 2009/27/EC of 7 April 2009 amending certain Annexes to Directive 2006/49/EC of the European Parliament and of the Council as regards technical provisions concerning risk management;

Commission Directive 2009/83/EC of 27 July 2009 amending certain Annexes to Directive 2006/48 of the European Parliament and of the Council as regards technical provisions concerning risk management;

Directive 2009/111/EC of the European Parliament and of the Council of 16 September 2009 amending Directives 2006/48/EC, 2006/49/EC and 2007/64/EC as regards banks affiliated to central institutions, certain own funds items, large exposures, supervisory arrangements, and crisis management;

Directive 2010/76/EU of the European Parliament and of the Council of 24 November 2010 amending Directives 2006/48/EC and 2006/49/EC as regards capital requirements for the trading book and for re-securitisations, and the supervisory review of remuneration policies.

FINAL AND TRANSITIONAL PROVISIONS

§ 6. (amended; Darjaven Vestnik, issue 38 of 2008, effective as of 11 April 2008) This Ordinance is issued on the grounds of Articles 40, 49, 50 and 70 in connection with § 13 of the Transitional and Final Provisions of the Law on Credit Institutions and is approved with Decision No. 163 of the Governing Council of the Bulgarian National Bank from 14 December 2006.

§ 7. This Ordinance shall come into effect from the date for which the Law on Credit Institutions comes to force

§ 8. In Ordinance No. 8 on banks' capital adequacy, adopted by Decision 161/23.12.2004 of the Governing Council of BNB, (published in Darjaven Vestnik, No. 5 of 14 January 2005; effective as of1 July 2005; amended., No. 55 of 5 July 2005, effective as of1 July 2005; amend., No. 19 of 2 March 2006, effective as of1 April 2006) are made the following amendments:

1. In the title of the Ordinance the figure 8 is replaced by 38;

2. New Article 1 is created:

"Article 1. This Ordinance is applied only in the cases and for the purposes defined in paragraphs 9 – 10 in Ordinance No. 8 on credit institutions' capital adequacy";

3. Current Article 1 becomes Article 1a.

§ 9. (1) Credit institutions calculating risk weighted exposure amounts under IRB approaches shall during 2007, 2008 and 2009 provide own funds which are at all times more than or equal to the following amounts:

1. during 2007 the amount of own funds shall be 95% of the total minimum amount of own funds required to be held during that period by the bank under Article 8 of Ordinance No. 38;

2. during 2008 the amount of own funds shall be 90% of the total minimum amount of own funds required to be held during that period by the bank under Article 8 of Ordinance No. 38;

3. during 2009 the amount of own funds shall be 80% of the total minimum amount of own funds required to be held during that period by the bank under Article 8 of Ordinance No. 38.

(2) Compliance with the requirements of paragraph 1 shall be on the basis of amounts of own funds fully adjusted to reflect differences in the calculation of own funds under Ordinance No. 38 and the calculation of own funds under this Ordinance.

(3) Credit institutions using the Advanced Measurement Approaches for the calculation of their capital requirements for operational risk shall, during 2008 and 2009, provide own funds which are at all times more than or equal to the amounts indicated in paragraph 1, items 2 and 3

§ 10. (1) Until 1 January 2008, after permission of BNB, banks may calculate the amount of risk weighted assets for credit risk, in accordance with Articles 12 – 26 of Ordinance No. 38.

(2) Where the discretion referred to in paragraph 1 is exercised; the following shall apply in relation to the treatment of exposures for which the Standardised Approach is used:

1. the banks do not apply the following chapters from Part Two *Capital Requirements for Credit Risk* – Chapter Four *Standardised Approach*, Chapter Six *Credit Risk Mitigation* and Chapter Seven *Securitisation Framework* from this Ordinance;

2. the capital requirement for operational risk shall be reduced by the percentage representing the ratio of the value of the credit institution's exposures for which risk weighted exposure amounts are calculated in accordance with the discretion referred to in paragraph 1 to the total value of its exposures;

3. when this Ordinance refers to the application of articles under Chapter Four *Standardised Approach* instead shall be applied the articles under Chapter Three of Ordinance No. 38;

4. Article 11 and Articles 335 – 339 shall not apply

(3) Banks who apply the treatment under paragraphs 1 and 2:

1. maintain capital adequacy ratio of 14% under Article 22, paragraph 4 and 7% under Article 22, paragraph 5.

2. perform additional parallel reporting for the risk weighted assets as without applying this ordinance.

§ 11. (amended; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010;) Until 31 December 2015 the risk weight under Article 28, paragraph 3 shall be assigned in relation to exposures to Member States' central governments or central banks denominated and funded in the domestic currency of any Member State.

§ 12. The Deputy Governor heading the Banking Supervision Department, issues guidance for the application of this Ordinance.

Ordinance on Amendment of Ordinance No. 8 of 2006 on the Capital Adequacy of Credit Institutions

(published; Darjaven Vestnik, issue 62 of 2007)

……………………………………………………………………………………

§ 2. This Ordinance is issued on the grounds of Commission Directive 2007/18/EC of 27 March 2007 amending Directive 2006/48/EC of the European Parliament and of the Council as regards the exclusion or inclusion of certain institutions from its scope of application and the treatment of exposures to multilateral development banks.

Final Provisions
to the Ordinance on Amendment of Ordinance No. 8 of 2006 on the Capital Adequacy of Credit Institutions

(published; Darjaven Vestnik, issue 38 of 2008)

………………………………………………………………………………………

§ 32. This Ordinance is issued on the grounds of Articles 40, 49, 50 and 70 in connection with § 13 of the Transitional and Final Provisions of the Law on Credit Institutions and is adopted by Resolution No. 17 of 3 April 2008 of the Governing Council of the Bulgarian National Bank. It shall come into effect as of the date of its publication in the Darjaven Vestnik.

Transitional and Final Provisions
to the Ordinance on Amendment of Ordinance No. 8 of 2006 on the Capital Adequacy of Credit Institutions

(published; Darjaven Vestnik, issue 21 of 2009)

§ 10. The first report under Ordinance No. 8 on the Capital Adequacy of Credit Institutions according to these amendments submitted to the Bulgarian National Bank shall include data as of 31 March 2009.

Transitional and Final Provisions
to the Ordinance on Amendment of Ordinance No. 8 of 2006 on the Capital Adequacy of Credit Institutions

(published; Darjaven Vestnik, issue 20 of 2010)

§ 7. The first report under Ordinance No. 8 on the Capital Adequacy of Credit Institutions according to these amendments submitted to the Bulgarian National Bank shall include data as of 31 March 2010.

Transitional and Final Provisions to the Ordinance on Amendment of Ordinance No. 8 of 2006 on the Capital Adequacy of Credit Institutions

(published; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010)

§ 53. Article 194a shall apply to new securitisations initiated after 1 January 2011, and as regards the existing securitisations where new underlying exposures are added or substituted after this date – on or after 1 January 2015.

§ 54. (1) The Bulgarian National Bank shall disclose by 31 December 2010 the general criteria and methodologies adopted to review the compliance with Article 194a.

(2) The first disclosure under Article 194a, paragraph 16 shall be based on the data as of 31 December 2011.

§ 55. This Ordinance is issued on the grounds of Article 16, item 5 of the Law on the Bulgarian National Bank and Articles 40, 49, 50 and 70 in connection with § 13 of the Transitional and Final Provisions of the Law on Credit Institutions and is adopted by Resolution No. 93 of 6 October 2010 of the Governing Council of the Bulgarian National Bank.

§ 56. The first report under Ordinance No. 8 on the Capital Adequacy of Credit Institutions according to these amendments submitted to the Bulgarian National Bank shall include data as of 31 December 2010.

§ 57. This Ordinance shall come into effect as of 31 December 2010, except for paragraph 5, which shall be effective as of 30 April 2011.

Transitional and Final Provisions to the Ordinance on Amendment of Ordinance No. 8 of 2006 on the Capital Adequacy of Credit Institutions

(published; Darjaven Vestnik, issue 102 of 2010, effective as of 1 January 2011)

§ 11. (1) Credit institutions which have received a permission to use an IRB approach for the calculation of their capital requirements for credit risk shall until 31 December 2011 provide own funds which are at all times more than or equal to 80% of the minimum amount of own funds specified in Article 8 of the BNB Ordinance No. 38 of 2004 on the Capital Adequacy of Banks.

(2) For the purposes of paragraph 1, credit institutions shall adjust the amount of own finds under this Ordinance, taking into account the differences resulting from the treatment of expected and unexpected losses compared to the own funds under BNB Ordinance No. 38 of 2004 on the Capital Adequacy of Banks.

(3) Credit institutions which have received a permission to use an Advanced Measurement Approaches for the calculation of their capital requirements for operational risk shall until 31 December 2011 maintain own funds which are at all times more than or equal to the amount under paragraph 1.

(4) A bank which has received a permission to use an IRB Approach referred to in Article 57, paragraphs 1 and 5 or the Advanced Measurement Approaches referred to in Article 318, paragraph 7 shall calculate the capital requirements thresholds, as follows:

1. under paragraph 1 – 80% of the capital requirements for credit risk using the Standardised Approach;

2. under paragraph 3 – 80% of the capital requirements for operational risk using the Basic Indicator Approach.

§ 12. Until 31 December 2012 the exposure weighted average LGD for all retail exposures secured by residential properties and not benefiting from guarantees from central governments shall not be lower than 10%.

§ 13. Until 31 December 2013 the 10% limit under Article 41, paragraph 3 in connection with Article 41, paragraph 2, item 5 shall not be applied provided that:

1. the securitised residential or commercial real estate exposures have been originated by a member of the same consolidated group of which the issuer of the covered bonds is also a member or by an entity affiliated to the same central body to which the issuer of the covered bonds is also affiliated (that common group membership or affiliation to be determined at the time the senior units are made collateral for covered bonds); and

2. a member of the same consolidated group of which the issuer of the covered bonds is also a member or an entity affiliated to the same central body to which the issuer of the covered bonds is also affiliated retains the whole first loss tranche supporting these senior units.

§ 14. This Ordinance is issued on the grounds of Article 16, item 5 of the Law on the Bulgarian National Bank and Articles 40, 49, 50 and 70 in connection with § 13 of the Transitional and Final Provisions of the Law on Credit Institutions and is adopted by Resolution No. 119 of 21 December 2010 of the Governing Council of the Bulgarian National Bank. It shall come into effect as of 1 January 2011.

Transitional and Final Provisions to the Ordinance on Amendment of Ordinance No. 8 of 2006 on the Capital Adequacy of Credit Institutions

(published; Darjaven Vestnik, issue 95 of 2011,
effective as of 31 December 2011)

§ 48. For a transitional period ending 31 December 2013, the banks shall sum separately their weighted net long positions and its weighted net short positions in accordance with Article 276b. The larger of those sums shall constitute the specific risk capital requirement. The banks shall, however, report to the Bulgarian National Bank the total sum of its weighted net long and net short positions, broken down by types of underlying assets.

§ 49. The first report under this Ordinance according to these amendments shall be submitted to the Bulgarian National Bank and shall include data as of 31 December 2011.

§ 50. This Ordinance is issued on the grounds of Article 16, item 5 of the Law on the Bulgarian National Bank and Articles 40 and 70 in connection with § 13 of the Transitional and Final Provisions of the Law on Credit Institutions and is adopted by Resolution No. 94 of 10 November 2011 of the Governing Council of the Bulgarian National Bank. It shall come into effect as of 31 December 2011.

Appendix 1

LIST OF DERIVATIVES

1. Interest rate contracts:
(a) interest rate swaps in one currency;
(b) underlying swaps;
(c) forward rate agreements;
(d) interest rate futures;
(e) interest rate options;
(f) other contracts of similar characteristics.

2. Foreign exchange contracts and gold contracts:
(a) interest rate swaps in different currencies;
(b) exchange rate forward contracts;
(c) exchange rate futures;
(d) exchange rate options;
(e) other contracts of similar characteristics;
(f) gold contracts with characteristics similar to the contracts under sub-items (a) to (e).

3. Contracts on equity instruments or commodities:
(a) equity or commodity swaps;
(b) equity or commodity forward contracts;
(c) equity or commodity futures;
(d) equity or commodity options and warrants;
(e) other contracts of similar characteristics.

4. Credit derivatives.
(a) credit default swaps;
(b) total rate of return swaps;
(c) credit linked notes;
(d) other instruments of similar characteristics.

5. Options, futures, swaps, FRA and other derivative contracts related to climate events, and annual gross incomes, emission allowances, inflation rates, other official economic statistics, as well as other contracts relating to assets, rights, obligations, indexes and measures, which have characteristics of derivative financial instruments traded on a regulated market or by a MTF (multi-trading facility), or are settled through a clearing house, or are subject to margin calls.

Appendix 2

CLASSIFICATION OF OFF BALANCE SHEET ITEMS

1. Off-balance sheet items with a 100% conversion factor:
(a) Guarantees having the character of credit substitutes;
(b) Credit derivatives;
(c) Acceptances;
(d) Endorsements on bills not bearing the name of another bank;
(e) Transactions with recourse;
(f) Irrevocable standby letters of credit having the character of credit substitutes;
(g) Assets purchased under outright forward purchase agreements;
(h) Forward-forward deposits;
(j) The unpaid portion of partly-paid shares and securities;
(k) Asset sale and repurchase agreements;
(l) Other items also carrying full risk.

2. Off-balance sheet items with a 50% conversion factor:
(a) Documentary credits issued and confirmed;
(b) Warranties and indemnities (including tender, performance, customs and tax bonds) and guarantees not having the character of credit substitutes;
(c) Irrevocable standby letters of credit not having the character of credit substitutes;
(d) Undrawn credit facilities (agreements to lend, purchase securities, provide guarantees or acceptance facilities) with an original maturity of more than one year;
(e) Note issuance facilities (NIFs) and revolving underwriting facilities (RUFs);
(f) Other items also carrying medium risk.

3. Off-balance sheet items with a 20% conversion factor:
(a) Documentary credits in which underlying shipment acts as collateral and other self-liquidating transactions;
(b) Undrawn credit facilities (agreements to lend, purchase securities, provide guarantees or acceptance facilities) with an original maturity of up to and including one year which may not be cancelled unconditionally at any time without notice or that do not effectively provide for automatic cancellation due to deterioration in a borrower's creditworthiness;
(c) Other items also carrying low risk.

4. Off-balance sheet items with a zero conversion factor
(a) Undrawn credit facilities (agreements to lend, purchase securities, provide guarantees or acceptance facilities) which may be cancelled unconditionally at any time without notice, or that do effectively provide for automatic cancellation due to

deterioration in a borrower's creditworthiness. Retail credit lines may be considered as unconditionally cancellable if the terms permit the bank to cancel them to the full extent allowable under consumer protection and related legislation; and

(b) Other items also carrying no risk.

Appendix 3

STANDARDISED APPROACH FOR CREDIT RISK

(amended; Darjaven Vestnik, issue 62 of 2007; amended; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010)

List 1 Multilateral Development Banks

1. International Bank for Reconstruction and Development;
2. International Finance Corporation;
3. Inter-American Development Bank;
4. Inter-American Investment Corporation;
5. Central American Bank for Economic Integration;
6. Asian Development Bank;
7. African Development Bank;
8. Council of Europe Development Bank;
9. Nordic Investment Bank;
10. Caribbean Development Bank;
11. Black Sea Trade and Development Bank;
12. European Bank for Reconstruction and Development;
13. European Investment Bank;
14. European Investment Fund;
15. Multilateral Investment Guarantee Agency;
16. (new; Darjaven Vestnik, issue 62 of 2007) International Finance Facility for Immunisation;
17. (new; Darjaven Vestnik, issue 62 of 2007) Islamic Development Bank.

List 2 International Organisations

1. European Community;
2. International Monetary Fund;
3. Bank for International Settlements.

Table 1 Risk weights for the exposures to central governments or central banks with credit assessment by eligible ECAI

Credit quality step	1	2	3	4	5	6
Risk weight	0%	20%	50%	100%	100%	150%

Table 2 Risk weights for exposures to central governments or central banks with credit assessment by eligible ECA

MEIP	0	1	2	3	4	5	6	7
Risk weight	0%	0%	20%	50%	100%	100%	100%	150%

Table 3 Risk weights for exposures to institutions with residual maturity more than 3 months

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

Table 4 Risk weights for exposures to institutions with residual maturity less than or equal to 3 months

Credit quality step	1	2	3	4	5	6
Risk weight	20%	20%	20%	50%	50%	150%

Table 5 Risk weights for exposures to corporates with credit assessment by eligible ECAI

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

Table 6 Risk weights for exposures to covered bonds

Risk weight of the issuer's first-rate unsecured debt	20%	50%	100%	150%
Risk weight of the exposure	10%	20%	50%	100%

Table 7 Risk weights for short-term exposures to institutions and corporates

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

Table 8 Risk weights for exposures to CIUs with credit assessment by eligible ECAI

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

Appendix 4

INTERNAL RATINGS BASED APPROACH

(amended; Darjaven Vestnik, issue 38 of 2008, effective as of 11 April 2008; amended; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011)

Table 1 Specialized lending exposures

Residual maturity	**Category 1**	**Category 2**	**Category 3**	**Category 4**	**Category 5**
Less than 2.5 years	50%	70%	115%	250%	0%
Equal to or more than 2.5 years	70%	90%	115%	250%	0%

Table 2 Expected loss for specialized lending exposures

Residual maturity	**Category 1**	**Category 2**	**Category 3**	**Category 4**	**Category 5**
Less than 2.5 years	0%	0.4%	2.8%	8%	50%
2.5 years or more	0.4%	0.8%	2.8%	8%	50%

Formula 1

Risk-weighted exposure = RWc * Exposure value

Formula 2

Risk weight RWc = $(LGD * N[(1 - Rc)^{-0.5} * G(PD) + (Rc /(1 - Rc))^{0.5} * G(0.999)] - PD * LGD)*(1 - 1.5*b)^{-1} * (1 +(M - 2.5)* b)*12.5*1.06$

Formula 3

Correlation coefficient (Rc) = 0.12 x (1 – EXP(- 50 * PD))/(1 – EXP(- 50)) + 0.24 * [1 – (1 – EXP(- 50 * PD))/(1 – EXP(- 50))]

Formula 4

(amended; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011)

Maturity factor (b) = $[0,11852 - 0,05478*\ln(PD)]^2$,

where: N(x) denotes a cumulative distribution function for the standard normal random variable (i.e. the probability that a normal random variable with mean zero and variance of one is less than equal to x);

G(z) – denotes the inverse cumulative distribution function for a standard normal random variable (i.e. the value x such that N(x) z).

For PD = 0, RW shall be 0.

Formula 5

$(RWc) = Max\{0, 12.5 *(LGD – EL_{BE})\}$,

where EL_{BE} ELBE is the bank's best estimate of expected loss for the defaulted exposure according to Article 110, paragraph 8.

Formula 6

Risk-weighted value = Risk weight (RWc) * exposure value * (0.15 + 160*PDpp);

PDpp = PD of the credit protection provider.

Formula 2 shall be used to calculate the risk weight (RWc) for the exposure. The risk-weighted amount shall be calculated by using the PD of the obligor and the LGD of a comparable direct exposure to the protection provider. The maturity factor (b) shall be calculated by using the lower of the PD of the protection provider and the PD of the obligor.

Formula 7

Correlation coefficient (Rc)

0.12 x (1 – EXP(- 50 * PD))/(1 – EXP(– 50)) + 0.24 * = [1 – (1 – EXP(- 50 * PD))/(1 – EXP(- 50))] – 0.04 * (1 – (S – 5)/45)

In this formula S is expressed as total annual sales in millions of Euros with EUR 5 million <= S <= EUR 50 million. Reported sales of less than EUR 5 million shall be treated as if they were equivalent to EUR 5 million. For purchased receivables the total annual sales shall be the weighted average by individual exposures of the pool.

Formula 8

Risk-weighted exposure = RWr * Exposure value

Formula 9

$RWr = (LGD*N [(1 – Rr)^{-0.5}*G(PD) + (Rr /(1 – Rr))^{0.5}*G(0.999)]- PD*LGD)*12.5*1.06$

Formula 10

Correlation coefficient (Rr) = 0.03 x (1 – EXP(- 35 * PD))/(1 – EXP(- 35)) + 0.16 * [1 – (1 – EXP(- 35 * PD))/(1 – EXP(- 35))]

Formula 11

$RW = Max(0, 12.5*(LGD – EL_{BE}))$, where

EL_{BE} is the bank's best estimate of expected loss for defaulted exposures calculated according to Article 110, paragraph 8.

Formula 12

$M = MAX\{1; MIN\{\Sigma_t*CF_t/\Sigma CF_t; 5\}\}$, where: CF_t denotes the cash flows (principal, interest payments and fees) contractually payable by the obligor in period t;

Formula 13

$$M = MIN\left(\frac{\sum_{k=1}^{tk \le 1year} EffectiveEE_k * \Delta t_k * df_k + \sum_{tk > 1year}^{maturity} EE_k * \Delta t_k * df_k}{\sum_{k=1}^{tk \le 1year} EffectiveEE_k * \Delta t_k * df_k} ;5 \right)$$

df_k = the risk-free discount factor for future time period tk;
The remaining symbols are defined in Appendix 7 Counterparty credit risk.

Formula14
EL = PD x LGD
Expected loss amount = EL x exposure value, where
EL is expected loss;
PD is probability of default;
LGD is loss-given-default.

Appendix 5

CREDIT RISK MITIGATION

Table 1 Supervisory volatility adjustments

Credit quality step under the Standardised Approach with which the credit assessment of the debt security is associated	Residual maturity	Volatility adjustments for debt securities issued by entities described in Article 135, paragraph 1, item 2 *Liquidation period*			Volatility adjustments (%) for debt securities issued by entities described in Article 135, paragraph 1, items 3 – 5 *Liquidation period*		
		20-day	10-day	5-day	20-day	10-day	5-day
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 years	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	-	-	-
	> 1 <= 5 years	21.213	15	10.607	-	-	-
	> 5 years	21.213	15	10.607	-	-	-

Table 2 Supervisory volatility adjustments

Credit quality step under the Standardised Approach with hich the credit assessment of the short-term debt security is associated	Volatility adjustments (%) for debt securities issued by entities described in Article 135, paragraph 1, item 2 with short-term credit assessment			Volatility adjustments (%) for debt securities issued by entities described in Article 135, paragraph 1, items 3 - 5 with short-term credit assessment		
	Liquidation period			Liquidation period		
	20-day	10-day	5-day	20-day	10-day	5-day
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

	Liquidation period		
	20-day	10-day	5-day
Main Index Equities, Main Index Convertible Bonds	21.213	15	10.607
Equity instruments and 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 mismatches (%)

Liquidation period		
20-day	10-day	5-day
11.314	8	5.657

Table 5 Minimum LGD for secured parts of exposures

	Threshold level of C* (the required minimum collateralisation level for the exposure)	Higher threshold level of C**	LGD* for senior claims or contingent claims	LGD* for subordinated claims or contingent claims
Residential estates	30%	140%	35%	65%
Leasing	30%	140%	40%	70%

Formula 1

$H = \Sigma a_i H_i$,

where a_i is the proportion of an item (i) to the collateral as a whole, and H_i is the volatility adjustment applicable to that item.

Formula 2

$$H_M = H_N \sqrt{T_M / T_N}$$

where H_M is the volatility adjustment;

T_M is the relevant liquidation period for H_M;

H_N is the volatility adjustment based on the liquidation period T_N.

Formula 3

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

where:

H_M is the volatility adjustment where there is daily revaluation;

N_R is the actual number of business days between revaluations;

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

Formula 4

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

E^* – the net adjusted exposure value.

1. $E_{VA} = E \times (1 + H_E)$, where

E_{VA} is the volatility-adjusted exposure amount (for exposures in OTC derivatives $E_{VA} = E$);

E is the unsecured exposure;

H_E is the volatility adjustment appropriate to the exposure (E).

2. $C_{VAM} = C_{VA} \times M$, where

C_{VAM} is the adjusted value of the collateral;

M is the adjustment for maturity mismatches by formula 10;

$C_{VA} = C \times (1 - H_C - H_{FX})$, where

C_{VA} is the volatility-adjusted value of the collateral before being adjusted for any currency mismatch;

C – the value of the collateral;

H_C – the volatility adjustment appropriate to the collateral;

H_{FX} – the volatility adjustment appropriate to currency mismatches.

Formula 5

$LGD^* = LGD \times (E^*/E)$, where

LGD* is the adjusted (the effective) LGD for the purposes of the internal ratings based approach;

LGD is the LGD that would apply to the exposure if the exposure was not collateralised;

E* is the exposure value adjusted by Formula 4;

E is the value of uncollaterised exposure.

Formula 6

$E^* = \max \{0, [(\Sigma(E) - \Sigma(C)) + \Sigma(|NPS| \times H_{sec}) + (\Sigma|E_{fx}| \times H_{fx})]\}$

E* is the fully adjusted exposure value;

E is the exposure value for each separate exposure under the agreement that would apply in the absence of the credit protection;

C is the value of the securities or commodities borrowed, purchased or received or the cash borrowed or received;

NPS is the net positions in the same type of security or commodity;

E_{fx} is the net position (positive or negative) in a given currency other than the settlement currency of the agreement.

H_{sec} is the volatility adjustment appropriate to a particular type of security or commodity;

H_{fx} is the foreign exchange volatility adjustment for a given currency.

Formula 7

$E^* = \max \{0, [(\Sigma E - \Sigma C) + (VaR)]\}$, where

E* is the adjusted exposure value;

E is the exposure value for each separate exposure under the agreement that would apply in the absence of the credit protection;

C is the value of the securities or commodities borrowed, purchased or received or the cash borrowed or received;

VaR is the value at risk output of the internal model.

Formula 8

$G^* = G \times (1 - H_{FX})$, where

G^* is the adjusted value of the credit protection;

G is the nominal amount of the credit protection;

H_{fx} is the supervisory or own volatility adjustment for any currency mismatch, calculated according to the procedures for funded credit protection.

Formula 9

$RWE = (E - G_A) \times r + G_A \times g$, where

RWE is the risk-weighted exposure value;

E is the exposure value;

G_A is the value of the protection further adjusted for any maturity or currency mismatch by Formula 11;

r is the risk weight of exposures to the obligor;

g is the risk weight of exposures to the protection provider.

Formula 10

$C_{VAM} = C_{VA} \times M$, where

C_{VAM} is the value of the collateral further adjusted for any maturity mismatch;

C_{VA} is the volatility adjusted value of the collateral by formula 4 before being adjusted for any maturity mismatch;

$M = (t-t^*) / (T-t^*)$;

t is the number of years remaining to the maturity date of the credit protection, or the value of T, whichever is the lower;

T is the number of years remaining to the maturity date of the exposure, but not more than 5 years;

t^* is 0.25 (3 months);

Formula 11

$G_A = G^* \times M$, where

G_A is the value of the protection adjusted for any maturity mismatch;

G^* is the value of the protection adjusted for any currency mismatch by Formula 8;

M is calculated by Formula 10.

Appendix 6

SECURITISATION

(amended; Darjaven Vestnik, issue 38 of 2008, effective as of 11 April 2008; amended; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011)

Table 1 Positions with assigned credit assessment
(repealed; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011)

Credit Quality Step	1	2	3	4 (only for credit assessments other than short-term credit assessments)	All other credit quality steps
Securitisation positions	20%	50%	100%	350%	Own funds deduction
Re-securitisation positions	40%	100%	225%	650%	Own funds deduction

Table 2 Other positions with assigned credit assessment
(repealed; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011)

Credit quality step	1	2	3	4	All other
Risk weight	20%	50%	100%	350%	Deduction from the capital base

Table 3 Conversion factor

3 months average excess spread	Securitisations subject to a controlled early amortisation provision	Securitisations subject to a non-controlled early amortisation provision
over 133%	0%	0%
from 100% to 133%	1%	5%
from 75% to 100%	2%	15%
from 50% to 75%	10%	50%
from 25% to 50%	20%	100%
less than 25%	40%	100%

Table 4 Positions with assigned credit assessment
(repealed; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011)

Credit Quality Step		Securitisation Positions			Re-securitisation Positions	
Credit assessments other that short term	Short term credit assessment	A	B	C	D	E
1	1	7 %	12 %	20 %	20 %	30 %
2		8 %	15 %	25 %	25 %	40 %
3		10 %	18 %		35 %	50 %
4	2	12 %	20 %	35 %	40 %	65 %
5		20 %	35 %		60 %	100 %
6		35 %	50 %		100 %	150 %
7	3	60 %	75 %		150 %	225 %
8		100 %			200 %	350 %
9		250 %			300 %	500 %
10		425 %			500 %	650 %
11		650%			750%	Own funds deduction
All other and unrated		Own funds deduction				

Table 5 Positions with other assigned credit assessment
(repealed; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011)

Formula 1

$$N = \frac{(\sum_i EAD_i)^2}{\sum_i EAD_i^2},$$

where EAD_i represents the sum of the exposure values of all exposures to the respective obligor.

Formula 2
$N = 1/C_1$.

Formula 3
(repealed; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011)

12.5 x (S[L+T] – S[L])/T, where

$$S[x]=\begin{cases} x & за \quad x \le Kirbr \\ Kirbr + K[x] - K[Kirbr] + (d \cdot Kirbr/\omega)\left(1 - e^{\omega(Kirbr - x)/Kirbr}\right) & за \quad Kirbr < x \end{cases}$$

$$h = (1 - Kirbr / ELGD)^N$$

$$c = Kirbr / (1 - h)$$

$$v = \frac{(ELGD - Kirbr)\,Kirbr + 0.25\,(1 - ELGD)\,Kirbr}{N}$$

$$f = \left(\frac{v + Kirbr^2}{1 - h} - c^2\right) + \frac{(1 - Kirbr)Kirbr - v}{(1 - h)\,\tau}$$

$$g = \frac{(1 - c)c}{f} - 1$$

$$a = g \cdot c$$

$$b = g \cdot (1 - c)$$

$$d = 1 - (1 - h) \cdot (1 - Beta[Kirbr;\ a,\ b])$$

$$K[x] = (1 - h) \cdot ((1 - Beta[x;\ a, b])\,x + Beta[x; a + 1, b]\,c).$$

T (the thickness of the tranche in which the position is held) is measured as the ratio of the nominal amount of the tranche to the sum of the exposure values of the exposures that have been securitised. For the purposes of calculating T the exposure value of a derivative instrument, where the current replacement cost is not a positive value, shall be the potential future credit exposure;

L (the credit enhancement level) is measured as the ratio of the nominal amount of all tranches subordinate to the tranche in which the position is held to the sum of the exposure values of the exposures that have been securitised. Capitalised future income shall not be included in the measured L. Derivative instruments that represent tranches more junior than the tranche in question may be measured at their current replacement cost if it is positive;

Kirbr is the ratio of K_{irb} to the sum of the exposure values of the exposures that have been securitised. Kirbr is expressed in decimal form;

$$ELGD = \frac{\sum_i LGD_i \cdot EAD_i}{\sum_i EAD_i}$$

where

ELGD is the exposure-weighted average loss-given-default;

LGDi represents the average LGD associated with all exposures to the ith obligor. In the case of resecuritisation, an LGD of 100% shall be applied to the securitised positions. When default and dilution risk for purchased receivables are treated in an aggregate manner within a securitisation (e.g. a single reserve or over-collateralisation is available to cover losses from either source), the LGDi input shall be constructed as a weighted average of the LGD for credit risk and the 75% LGD for dilution risk. The weights shall be the stand-alone capital charges for credit risk and dilution risk respectively.

N is the effective number of exposures calculated in accordance with Formula 2. In the case of re-securitisations, the bank shall look at the number of securitisation exposures in the pool and not the number of underlying exposures in the original pools;

Beta [x; a, b] refers to the cumulative beta distribution with parameters a and b evaluated at x;

t = 1000;

w = 20.

Formula 4

$$N = \left(C_1 C_m + \left(\frac{C_m - C_1}{m - 1} \right) \max\{1 - m C_1, 0\} \right)^{-1}$$

where

C_m is the ratio of the sum of the exposure values of the largest „m“ exposures to the sum of the exposure values of the exposures securitised . The level of „m“ may be set by the bank.

Formula 5

RWE = G_A * RWg + (E – G_A)*RWe, where

RWE is the risk-weighted exposure amount;

E is the exposure amount;

G_A is the value of the protection further adjusted for any currency or maturity mismatch in

accordance with Chapter Six of Part Two Credit risk mitigation;

RWe is the risk weight of exposures to the obligor;

RWg is the risk weight of exposures to the protection provider.

Формула № 6

RW* = [RW_S x (t-0.25)/(T-0.25)] + [RW_A x (T-t)/(T-0.25)], where

RW* is the risk weight resultant from the calculation;

RW_A is risk-weighted exposure amounts for exposures if they had not been securitised;

RW_S is the risk weight calculated under Article 227 provided that there was no maturity mismatch;

T is the residual maturity of the underlying exposures expressed in years;

t is the residual maturity of the credit protection expressed in years.

Appendix 7

COUNTERPARTY CREDIT RISK

(amended; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December)

Table 1 Mark-to-market method

Residual maturity	Interest rate contracts	Exchange rate contracts and gold contracts	Contracts on equity instruments	Precious metals contracts, except gold	Other commodity contracts
up to 1 year	0%	1%	6%	7%	10%
from 1 to 5 years	0.5%	5.0%	8%	7%	12%
over 5 years	1.5%	7.5%	10%	8%	15%

Notes:

1. Contracts which do not fall under any one of the five categories above will be included in "Other commodity contracts".

2. For contracts with multiple exchanges of principal, the percentages have to be multiplied by the number of remaining payments still to be made according to the contract.

3. For contracts that are structured to settle outstanding exposure following specified payment dates and where the terms are reset such that the market value of the contract is zero on these specified dates, the residual maturity would be equal to the time until the next reset date. In the case of interest-rate contracts that meet these criteria and have a remaining maturity of over one year, the percentage shall be no lower than 0.5%.

Table 2 Hedging sets

Residual maturity	Reference interest rates based on government securities	Other reference interest rates
up to 1 year	X	X
from 1 to 5 years	X	X
over 5 years	X	X

Table 3 Hedging sets

Hedging sets	CCRM
1. Interest rate positions	0.2%
2. Interest rate positions arising from reference debt instruments relating to a credit default swap for which the capital requirement under Table 1 in Appendix 9 Market Risks is not more than 1.6%	0.3%
3. Interest rate positions arising from debt instruments or reference debt instruments relating to a credit default swap for which the capital requirement under Table 1 in Appendix 9 Market Risks is over 1.6%	0.6%
4. Exchange rate positions	2.5%
5. Positions from instruments for electric power	4.0%
6. Gold positions	5.0%
7. Equity positions	7.0%
8. Positions in other precious metals	8.5%
9. Positions in other commodities	10.0%
10. Positions in other underlying instruments relating to OTC derivatives	10.0%

Note: Underlying instruments of OTC derivatives, as referred to in point 10, shall be assigned to separate individual hedging sets for each category of underlying instrument;

Formula 1

$$ExpVal = \beta * \max\left(CMV - CMC; \sum_j \left|\sum_i RPT_{ij} - \sum_l RPC_{lj}\right| * CCRM_j\right),$$

where:

CMV is current market value of the portfolio of transactions within the netting set with a counterparty gross of collateral, that is, where:

$CMC = \Sigma_i \, CMC_i$,

where:

CMV_i is the current market value of transaction *i*;

CMC – is the current market value of the collateral assigned to the netting set, that is, where:

$CMC = \Sigma_l \, CMC_l$,

where:

CMC_l is the current market value of collateral *l*;

i is index designating transaction;

l is index designating collateral;

j is index designating hedging set category. These hedging sets 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} is risk position from transaction *i* with respect to hedging set *j*;

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

CCRMj is *CCR* Multiplier set out in Table 3 with respect to hedging set *j*;

β is 1.4.

Formula 2

$$ENV = p_{ref} * \frac{\partial V}{\partial p},$$

:

ENV is (delta equivalent) effective notional value;

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

V is value of the financial instrument (in the case of an option this is the option price and in the case of a transaction with a linear risk profile this is the value of the underlying instrument itself);

p is price of the underlying instrument, expressed in the same currency as *V*.

Formula 3

$$ENVMD = \frac{\partial V}{\partial r},$$

ENVMD is (delta equivalent) effective notional value multiplied by the modified duration;

V is value of the financial instrument (in the case of an option this is the option price and in the case of a transaction with a linear risk profile this is the value of the underlying instrument itself or of the payment leg, respectively). If *V* is denominated in a currency other than the reference currency, the derivative must be converted into the reference currency by multiplication with the relevant exchange rate;

r is interest rate level.

Formula 4

$EEE_{ik} = \max(EEE_{tk-1}; EE_{tk})$, where:

EEE_{ik} is effective expected exposure in time t_k;

EE_{tk} is expected exposure in time t_k;

t_0 is current date;

EEE_{t0} equals current exposure.

Формула № 5

The effective expected positive exposure computed as the average Effective EE at a series of future dates:

$$EEPE = \sum_{k=1}^{m} EEE_{tk} * \Delta t_k ,$$

where: EEPE is effective expected positive exposure;

$\Delta t_k = t_k - t_{k-1}$ the time period as a difference between two dates;

t_m – is the time to the maturity of the longest contract, but not more than 1 year.

Formula 6

$PCE_{net} = 0.4*PCE_{gross} + 0.6*NGR* PCE_{gross}$,

where:

PCE_{net} is the reduced (net) figure for potential future credit exposure for all contracts with a given counterparty included in the netting agreement;

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

NGR is the quotient of the net replacement cost for all contracts included in the netting agreement with a given counterparty (numerator) and the gross replacement cost for all contracts included in the netting agreement with that counterparty (denominator);

Appendix 8

SETTLEMENT RISK

Table 1 Factors for potential loss

Number of working days after the delivery date	Factor %
01	02
5-15	8
16-30	50
31-45	75
46 and more	100

Appendix 9

MARKET RISKS

(amended; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010)

Table 1 Specific risk on debt instruments

Categories	Specific risk capital charge
Debt securities issued by: - central governments, including guaranteed by them; - central banks; - regional or local governments of member-states; - international organisations; - multilateral development banks under Appendix 3, which would qualify for credit quality step 1 or which would qualify for a 0% risk weight under the Standardised approach for determining the credit risk capital charge.	0%
Debt securities issued by: - central governments, including guaranteed by them; - central banks; - regional or local governments of member-states; - international organisations; - multilateral development banks under Appendix 3, which would qualify for credit quality step 2 or 3 under the Standardised approach for determining the credit risk capital charge; Debt securities issued or guaranteed by institutions which would qualify for credit quality step 1, 2 or 3 under the standardised approach; Debt securities issued or guaranteed by corporates which would qualify for credit quality step 1, 2 or 3 under the standardised approach; Other qualifying items	0.25% (residual maturity of up to 6 months) 1.00% (residual maturity greater than 6 months and up to and including 24 months) 1.60% (residual maturity exceeding 24 months)
Debt securities issued by: - central governments, including guaranteed by them; - central banks; - regional or local governments of member-states; - international organisations; - multilateral development banks under Appendix 3, - institutions, which would qualify for credit quality step 4 or 5 under the Standardised approach for determining the credit risk capital charge; Debt securities issued or guaranteed by corporates which would qualify for credit quality step 4 under the Standardised approach. Exposures for which a credit assessment by a recognised ECAI is not available.	8.00%

Debt securities issued by: - central governments, including guaranteed by them; - central banks; - regional or local governments of member-states; - international organisations; - multilateral development banks under Appendix 3, - institutions, which would qualify for credit quality step 6 under the Standardised approach for determining the credit risk capital charge. Debt securities issued or guaranteed by corporates which would qualify for credit quality step 5 or 6 under the standardised approach.	12.00%

Table 2 Maturity-based approach for the general risk of debt instruments

Zone	Maturity band		Weight (in %)
	Coupon of 3% or more	Coupon of less than 3 %	
01	02	03	04
I	0 ≤ 1 month	0 ≤ 1 month	0.00
	> 1 ≤ 3 months	> 1 ≤ 3 months	0.20
	> 3 ≤ 6 months	> 3 ≤ 6 months	0.40
	> 6 ≤ 12 months	> 6 ≤ 12 months	0.70
II	> 1 ≤ 2 years	> 1 year ≤ 1 year and 9 m.	1.25
	> 2 ≤ 3 years	> 1 years and 9 m. ≤ 2 years and 8 m.	1.75
	> 3 ≤ 4 years	> 2 years and 8 m. ≤ 3 years and 6 m.	2.25
III	> 4 ≤ 5 years	> 3years and 6 m. ≤ 4 years and 3 m.	2.75
	> 5 ≤ 7 years	> 4 years and 3 m. ≤ 5 years and 7 m.	3.25
	> 7 ≤ 10 years	> 5 years and 7 m. ≤ 7 years and 3 m.	3.75
	> 10 ≤ 15 years	> 7 years and 3 m. ≤ 9 years and 3 m.	4.50
	> 15 ≤ 20 years	> 9 years and 3 m. ≤ 10 years and 6 m.	5.25
	> 20 years	> 10 years and 6 m. ≤ 12 years	6.00
		> 12 ≤ 20 years	8.00
		> 20 years	12.50

Table 3 Duration-based approach for general risk of debt instruments

Zone	Modified duration	Assumed interest rate change (in %)
01	02	03
I	0 to 1	1.00
II	From 1 to 3.6	0.85
III	More than 3.6	0.70

Table 4 Reduction factors

Working day	Reduction factor
01	02
Working day 0	100%
Working day 1	90%
working days 2 to 3	75%

working day 4	50%
working day 5	25%
after working day 5	0%

Table 5 Plus factors

Number of overshootings	Plus-factor
01	02
Fewer than 5	0.00
5	0.40
6	0.50
7	0.65
8	0.75
9	0.85
10 or more	1.00

Formula 1

Modified duration = Duration (D)/(1 + r)

$$D = \frac{\sum_{t=1}^{m} \frac{tC_t}{(1+r)^t}}{\sum_{t=1}^{m} \frac{C_t}{(1+r)^t}},$$

where:

r – yield to maturity;

C_t – cash flow in time t;

m – total maturity (the point in time of the last cash flow on the instrument).

Appendix 10

OPERATIONAL RISK

Table 1 Classification of the Types of Events Resulting in Losses

Event-type category	Definition
Internal fraud	Losses due to acts of a type intended to defraud, misappropriate property or circumvent regulations, the law or company policy, excluding diversity/discrimination events, which involves at least one internal party
External fraud	Losses due to acts of a type intended to defraud, misappropriate property or circumvent the law, by a third party
Employment Practices and Workplace Safety	Losses arising from acts inconsistent with employment, health or safety laws or agreements, from payment of personal injury claims, or from diversity/discrimination events
Clients, Products & Business Practices	Losses arising from an unintentional or negligent failure to meet a professional obligation to specific clients (including fiduciary and suitability requirements), or from the nature or design of a product
Damage to Physical Assets	Losses arising from loss or damage to physical assets from natural disaster or other events
Business disruption and ystem failures	Losses arising from disruption of business or system failures
Execution, Delivery & Process Management	Losses from failed transaction processing or process management, from relations with trade counterparties and vendors

Table 2 Banks' business lines

Business line	List of activities	Percentage
Corporate finance	Underwriting of financial instruments and/or placing of financial instruments on a firm commitment basis Fees for underwriting Investment advice Advice to undertakings on capital structure, industrial strategy and related matters and advice and services relating to the mergers and the purchase of undertakings Investment research and financial analysis and other forms of general recommendation relating to transactions in financial instruments	18%
Trading and sales	Dealing on own account Money broking Reception and transmission of orders in relation to one or more financial instruments Execution of orders on behalf of clients Placing of financial instruments without a firm commitment basis Operation of Multilateral Trading Facilities	18%
Retail brokerage (Activities with a individual physical persons or with small and medium sized entities meeting the criteria set out in Article 26, paragraph 2 for the retail exposure class)	Reception and transmission of orders in relation to one or more financial instruments Execution of orders on behalf of clients Placing of financial instruments without a firm commitment basis	12%

Commercial banking	Acceptance of deposits and other repayable funds Lending Financial leasing Guarantees and commitments	15%
Retail banking (Activities with a individual physical persons or with small and medium sized entities meeting the criteria set out in Article 26, paragraph 2 for the retail exposure class)	Acceptance of deposits and other repayable funds Lending Financial leasing Guarantees and commitments	12%
Payments and settlement	Money transmission services, Issuing and administering means of payment	18%
Agency services	Safekeeping and administration of financial instruments for the account of clients, including custodianship and relatedservices such as cash/ collateral management	15%
Asset management	Portfolio management Managing of UCITS Other forms of asset management	12%

Table 3 Minimum features of loss event types

Internal number	The unique number of the event in the operational risk data base
Event/causes	Description of the event/loss, including the causes for it
Loss amount	Specify the loss incurred by the bank
Unaccounted loss	The part of the loss that is not yet accounted for
Final amount	Yes/No (Status)
Directly recovered loss	The amount of loss already recovered by the bank through the activities of constraining the event repercussions
Loss recovered by risk transfer mechanisms	The amount of loss already recovered by risk transfer mechanisms
Loss expected to be recovered	The amount of loss expected to be recovered directly or by risk transfer mechanisms
Relatedness to another type of risk	Relatedness to credit / market risk
Corporate finance	Loss assigned to this business line
Trading and sales	Loss assigned to this business line
Retail brokerage	Loss assigned to this business line
Commercial banking	Loss assigned to this business line
Retail banking	Loss assigned to this business line
Payment and settlement	Loss assigned to this business line
Agency services	Loss assigned to this business line
Asset management	Loss assigned to this business line
Event type category	Specify the event type causing loss as per the classification in Table 1
Date of occurrence	The date when the event took place
Date of recognition	The date when the event is registered by the bank's information system
Date of the first payment through risk transfer mechanisms	The date when the first payment is received on an insurance policy or by other risk transfer mechanisms
Date of the last payment through risk transfer mechanisms	The date when the last payment is received on an insurance policy or by other risk transfer mechanisms

Formula 1

$$K = \left\{ \sum years_{1-3} \max\left[\sum \left(GI_{1-8} \times \beta_{1-8} \right), 0 \right] \right\} / 3$$

where:
K is the capital charge;
GI_{1-8} – – is gross annual income by business line;
β_{1-8} – fixed rate according to Table 2 of this Appendix.

Appendix 11

DISCLOSURES

(amended; Darjaven Vestnik, issue 38, effective as of 11 April 2008; amended; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010; amended; Darjaven Vestnik, issue 102 of 2010, effective as of 1 January 2011; amended; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011)

List 1 Scope and methods of consolidation

1. The name of the bank.

2. An outline of the differences in the basis of consolidation for accounting and prudential purposes, with a brief description of the entities that are:

a) fully consolidated;

b) proportionally consolidated;

c) deducted from the capital base;

d) neither consolidated nor deducted.

3. Any current or foreseen material, practical or legal impediment to the prompt transfer of own funds or repayment of liabilities among the parent undertaking and its subsidiaries;

4. The aggregate amount by which the actual capital base is less than the required minimum in all subsidiaries not included in the consolidation, and the name or names of such subsidiaries.

List 2 Policies and procedures for risk management

1. The strategies and processes to manage each type of risk;

2. The structure and organization of the relevant risk management function or other appropriate arrangements;

3. The scope and nature of risk reporting and measurement systems;

4. The policies for hedging and mitigating risk, and the strategies and processes for monitoring the continuing effectiveness of the hedges and mitigants.

List 3 Structure and elements of the capital base

1. (amended; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) Summary information on the main features of all own funds items and components thereof, including instruments referred to in Article 3a, instruments the provisions of which provide an incentive for the credit institution to redeem them.

2. (amended; Darjaven Vestnik, issue 85 of 2010, effective as of 31 December 2010) The amount of tier-one capital, with separate disclosure of all positive items, overall amount of the instruments referred to in Article 3a and the instruments the provisions of which provide an incentive for the credit institution to redeem them along with deductions.

3. The total amount of tier-two capital.

4. Deductions from tier-one and tier-two capital under Article 6, paragraph 2.
5. Total capital base, net of deductions and limits laid dawn in Article 6.

List 4 Capital requirements

1. A general description of the bank's approach to assessing the adequacy of its capital under Article 11, paragraphs 2 and 3.
2. The capital requirements by exposure classes for a bank using the Standardised Approach for credit risk after the multiplication under Article 7.
3. The capital requirements by exposure classes for a bank using the Internal Rating Based Approach for credit risk after the multiplication under Article 7. For the retail exposure class, the requirement applies to each of the categories of exposures to which the different correlations in Article 64 correspond. For the equity exposure class, thus requirement applies to:

a) the categories of exposures to which each of the approaches provided in Articles 66 – 68;

b) exchange traded exposures, private equity exposures in sufficiently diversified portfolios, and other exposures.

4. The market risk capital requirements after the multiplication under Article 7.
5. The items of the operational risk capital requirements after the multiplication under Article 7.

List 5 Exposures to counterparty credit risk

1. A discussion of the methodology used to assign internal capital and credit limits for counterparty credit risk exposures.
2. A discussion of policies for securing collateral and establishing credit reserves.
3. A discussion of policies with respect to wrong-way risk exposures.
4. An estimate of the impact of the amount of additional collateral the bank would have to provide given a downgrade in its credit rating.
5. Gross positive fair value of:

a) contracts;

b) netting benefits;

c) netted current credit exposure;

d) collateral held;

e) net derivative credit exposure. Net derivative credit exposure is the credit exposure both the benefits from legally enforceable netting agreements and collateral arrangements.

6. Measures for exposure value under the methods set out in Chapter Eight of Part Two *Counterparty Credit risk*.
7. The notional value of credit derivative hedges, and the distribution of current credit exposure by types of credit exposure.
8. Notional amount of credit derivative transactions, segregated between:

a) use for the bank's own credit portfolio; and

b) in its intermediation activities, including the distribution of the credit derivatives products used, broken down further by protection bought and sold within each product group.

List 6 Exposure to credit risk and dilution risk

1. The definitions for accounting purposes of “past due” and “impaired”.

2. A description of the approaches and methods adopted for determining value adjustments and provisions.

3. The total amount of exposures after accounting offsets and without taking into account the effects of credit risk mitigation, and the average amount of the exposures over the period broken down by different types of exposure classes.

4. The geographic distribution of the exposures, broken down in significant areas by material exposure classes, and further detailed if appropriate.

5. The distribution of the exposures by industry or counterparty type, broken down by exposure classes, and further detailed if appropriate.

6. The residual maturity breakdown of all the exposures, broken down by exposure classes, and further detailed if appropriate.

7. By significant industry or counterparty type, the amount of:

a) impaired exposures and past due exposures, provided separately;

b) value adjustments and provisions;

c) charges for value adjustments and provisions during the period.

8. The amount of the impaired exposures and past due exposures, provided separately, broken down by significant geographical areas including, if practical, the amount of value adjustments and provisions to each geographical area.

9. The reconciliation of changes in the value adjustments and provisions for impaired exposures, shown separately. The information shall comprise:

a) a description of the type of value adjustments and provisions;

b) the opening balances;

c) the amounts taken against the provisions during the period;

d) the amounts set aside or reversed for estimated probable losses on exposures during the period, any other adjustments including those determined by exchange rate differences, business combinations, acquisitions and disposals of subsidiaries, and transfers between provisions;

e) the closing balances.

List 7 Information about nominated ECAIs and EIAs under the Standardised Approach for credit risk

1. List of the nominated ECAIs and EIAs and reasons for any changes.

2. The exposure classes for which each ECAIs and EIAs is used.

3. A description of the process used to transfer the issuer and issue credit assessments onto items in the banking book.

4. The exposure values before and the exposure values after credit risk mitigation associated with each credit quality step, as well as those deducted form the capital base.

List 8 Internal models for market risk

(amended; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011)

1. For each sub-portfolio covered:

(a) the characteristics of the models used;

(b) for the capital charges in accordance with Articles 315a and 315e separately, the methodologies used and the risks measured through the use of an internal model including a description of the approach used by the bank to determine liquidity horizons, the methodologies used to achieve a capital assessment that is consistent with the required soundness standard and the approaches used in the validation of the model;

(c) a description of stress testing applied to the sub-portfolio;

(d) a description of the approaches used for back-testing and validating the accuracy and consistency of the internal models and modelling processes;

2. The scope of acceptance by the Bulgarian National Bank.

3. A description of the extent and methodologies for compliance with the requirements set out in Articles 14 – 18.

4. The highest, the lowest and the mean of the following:

(a) the daily value-at-risk measures over the reporting period and as per the period end;

(b) the stressed value-at-risk measures over the reporting period and as per the period end;

(c) the capital charges in accordance with Articles 315a and 315e separately over the reporting period and as per the period-end.

5. The amount of capital in accordance with Articles 315a and 315e separately, together with the weighted average liquidity horizon for each sub-portfolio covered.

6. A comparison of the daily end-of-day value-at-risk measures to the one-day changes of the portfolio's value by the end of the subsequent business day together with an analysis of any important overshooting during the reporting period.

List 9 Exposure to operational risk

1. The approaches for assessment of own funds requirements for operational risk used.

2. When and Advanced Measurement Approach is used for measuring operational risk – a description of the methodology, including a discussion of relevant internal and external factors considered in the credit institution's measurement approach. In the case of partial use, the scope and coverage of the different methodologies used.

List 10 Equities in the banking book

1. The differentiation between exposures based on their objectives, including for capital gains relationship and strategic reasons, and an overview of the accounting techniques and valuation methodologies used, including key assumptions and practices affecting valuation and any significant changes in these practices.

2. The balance sheet value, the fair value and, for those exchange-traded, a comparison to the market price where it is materially different from the fair value.

3. The types, nature and amounts of exchange-traded exposures, private equity exposures in sufficiently diversified portfolios, and other exposures.

4. The realised gains or losses arising from sales and liquidations in the period.

5. (amended; Darjaven Vestnik, issue 38 of 2008) The total unrealised gains or losses, the total latent revaluation gains or losses (unrecognized in the income statement or the balance sheet), and any of these amounts included in the capital base.

List 11 Interest rate risk in the banking book

1. The nature of the interest rate risk and the key assumptions (including assumptions regarding loan prepayments and behaviour of non-maturity deposits), and frequency of measurement of the interest rate risk.

2. The variation in earnings, economic value or other relevant measure used by the management for upward and downward rate shocks according to management's method for measuring the interest rate risk, broken down by currency.

List 12 Securitisation

(amended; Darjaven Vestnik, issue 95 of 2011, effective as of 31 December 2011)

1. A description of the bank's objectives in relation to securitisation activity.

2. The nature of other risks including liquidity risk inherent in securitised assets.

3. The type of risks in terms of seniority of underlying securitisation exposures and in terms of assets underlying those latter securitisation exposures assumed and retained with re-securitisation activity.

4. The different roles played by the bank in the securitisation process.

5. An indication of the extent of the bank's involvement in each of the roles referred to in item 2.

6. A description of the processes in place to monitor changes in the credit and market risk of securitisation exposures including, how the behaviour of the underlying assets impacts securitisation positions and a description of how those processes differ for re-securitisation positions.

7. A description of the bank's policy governing the use of hedging and unfunded protection to mitigate the risks of retained securitisation and re-securitisation positions, including identification of material hedge counterparties by relevant type of risk exposure.

8. The approaches to calculating risk weighted exposure amounts that the bank follows for its securitisation activities including the types of securitisation exposures to which each approach applies.

9. The types of Special Securitisation Purpose Entities that the bank, as sponsor, uses to securitise third-party exposures including whether and in what form and to what extent the bank has exposures to those entities, separately for on- and off-balance sheet exposures, as well as a list of the entities that the bank manages or advises and that invest in either the securitisation positions that the bank has securitised or in Special Securitisation Purpose Entities that the credit institution sponsors.

10. A summary of the bank's accounting policies for securitisation activities, including:

a) whether the transactions are treated as sales or financings;

b) the recognition of gains on sales;

c) the methods, key assumptions, inputs and changes from the previous period for valuing securitisation positions;

d) the treatment of synthetic securitisations if not covered by other accounting policies;

e) how assets awaiting securitisation are valued and whether they are recorded in the bank's non-trading book or the trading book;

f) policies for recognising liabilities on the balance sheet for arrangements that could require the bank to provide financial support for securitised assets.

11. The names of the ECAIs used for securitisations and the types of exposure for which each agency is used.

12. Where applicable, a description of the Internal Assessment Approach as set out in Article 217, including the structure of the internal assessment process and relation between internal assessment and external ratings, the use of internal assessment other than for IAA capital purposes, the control mechanisms for the internal assessment process including discussion of independence, accountability, and internal assessment process review, the exposure types to which the internal assessment process is applied and the stress factors used for determining credit enhancement levels, by exposure type.

13. An explanation of significant changes to any of the quantitative disclosures in items 14 – 16 since the last reporting period.

14. Separately for the trading and the non-trading book, the following information broken down by exposure type:

a) the total amount of outstanding exposures securitised by the bank, separately for traditional and synthetic securitisations and securitisations for which the bank acts only as sponsor;

b) the aggregate amount of on-balance sheet securitisation positions retained or purchased and off-balance sheet securitisation exposures;

c) the aggregate amount of assets awaiting securitisation;

d) for securitised facilities subject to the early amortisation treatment, the aggregate drawn exposures attributed to the originator's and investors' interests respectively, the aggregate capital requirements incurred by the bank against the originator's interest and the aggregate capital requirements incurred by the bank against the investor's shares of drawn balances and undrawn lines;

e) the amount of securitisation positions that are deducted from own funds;

f) a summary of the securitisation activity of the current period, including the amount of exposures securitised and recognised gain or loss on sale.

15. Separately for the trading and the non-trading book, the following information:

a) the aggregate amount of securitisation positions retained or purchased and the associated capital requirements, broken down between securitisation and re-securitisation exposures and further broken down into a meaningful number of risk-weight or capital requirement bands, for each capital requirements approach used;

b) the aggregate amount of re-securitisation exposures retained or purchased broken down according to the exposure before and after hedging/insurance and the exposure to financial guarantors, broken down according to guarantor creditworthiness categories or guarantor name.

16. For the non-trading book and regarding exposures securitised by the bank, the amount of impaired/past due assets securitised and the losses recognised by the bank during the current period, both broken down by exposure type.

17. For the trading book, the total outstanding exposures securitised by the bank and subject to a capital requirement for market risk, broken down into traditional/synthetic and by exposure type.

List 13 Internal Rating Based Approach

1. The approach and the transition period approved by the BNB.

2. An explanation and review of:

a) the structure of internal rating systems and relation between internal and external ratings;

b) the use of internal estimates other than for calculating risk-weighted exposure amounts under the Internal Rating Based Approach;

c) the process for managing and recognising credit risk mitigation; and

d) the control mechanisms for rating systems including a description of independence, accountability, and rating systems review.

3. A description of the internal ratings process, provided separately for the following exposure classes:

a) central governments and central banks;

b) institutions;

c) corporates, including SMEs, specialised lending and purchased corporate receivables;

d) retail exposures, for each of the categories of exposures to which the different correlations in Article 64 correspond; and

e) equities.

The description under item 3 shall include the distribution within exposure classes, the definitions, methods and data for evaluation and verification of PDs and, if used, LGDs and conversion factors, including the assumptions and a description of any material diversions from the 'default' definition under Articles 101 – 102, as well as the segments affected by these diversions.

4. The exposure values for each of the exposure classes to central governments and central banks, institutions and corporates where a bank uses own estimates of LGDs or conversion factors for the calculation of risk-weighted exposure amounts under the Internal Rating Based Approach shall be disclosed separately from exposures for which the credit institution does not use such estimates.

5. For each of the exposure classes central government and central banks, institutions, corporates and equity, and across a sufficient number of obligor grades (including default) to allow for a meaningful differentiation of credit risk, banks shall disclose:

a) the total exposures (for the exposure classes central governments and central banks, institutions and corporates, the sum of outstanding loans and exposure values for undrawn commitments; for equities, the outstanding amount);

b) for a bank using own LGD estimates – the exposure-weighted average LGD in percentage;

c) the exposure-weighted average risk weight;

d) for a bank using own estimates of conversion factors – the amount of undrawn commitments and exposure-weighted average exposure values for each exposure class.

6. For the retail exposure class and for each of the categories as defined under item 5 (d), either the disclosures outlined under item 5 (if applicable, on a pooled basis), or an analysis of exposures (outstanding loans and exposure values for undrawn commitments) against a sufficient number of EL grades to allow for a meaningful differentiation of credit risk.

7. The actual value adjustments in the preceding period for each exposure class for retail and for each of the categories as defined under item 5 (d) and how they differ from past experience.

8. A description of the factors that impacted on the loss experience in the preceding period.

9. Information on estimates against actual losses in each exposure class for retail and for each of the categories as defined under item 5 (d) over a period sufficient to allow for a meaningful assessment of the performance of the internal rating processes. Where appropriate, the bank shall further decompose this to provide analysis of PD and, for the banks using own estimates of LGDs and/or conversion factors,

LGD and conversion factor outcomes against estimates provided in the quantitative risk assessment disclosures above.

List 14 Credit risk mitigation techniques

1. The policies and processes for, and an indication of the extent to which the entity makes use of, on- and off-balance sheet netting.
2. The policies and processes for collateral valuation and management.
3. A description of the main types of collateral taken by the bank.
4. The main types of guarantor and credit derivative counterparty and their creditworthiness.
5. Information about market or credit risk concentrations within the credit mitigation taken.
6. For a bank not providing own estimates of LGDs or conversion factors in respect of the exposure class, separately for each exposure class, the total exposure value (after, where applicable, on- or off-balance sheet netting) that is covered – after the application of volatility adjustments – by eligible financial collateral, and other eligible collateral.
7. Separately for each exposure class, the total exposure (after, where applicable, on- or off-balance sheet netting) that is covered by guarantees or credit derivatives. For the equity exposure class, this requirement applies to each of the approaches provided for in Articles 66 – 68.

List 15 Remuneration Policy and Practices

(new; Darjaven Vestnik, issue 102 of 2010, effective as of 1 January 2011)

1. Information concerning the decision-making process used for determining the remuneration policy, including, if applicable, information about the composition and mandate of a remuneration committee, the external consultant and the relevant stakeholders.
2. Information on the link between the remuneration and performance.
3. The most important structural characteristics of the remuneration system, including information on the criteria used for performance measurement and risk adjustment, deferral policy and vesting criteria.
4. Information on the performance criteria on which the entitlement to shares, options or variable components of remuneration is based.
5. The main parameters and rationale for any variable component scheme and any other non-cash benefits.
6. Aggregate quantitative information on remuneration broken down by business area.
7. Aggregate quantitative information on remuneration broken down by persons referred to in Article 2, items 1, 2 and 4 of BNB Ordinance No. 4 of 2010 on the Requirements on the Remuneration in Banks specifying:

a) the amount of remuneration for the financial year split into fixed and variable remuneration, and the number of beneficiaries;

b) the amounts and forms of variable remuneration split into cash, shares, share-linked instruments and other types;

c) the amounts of outstanding deferred remuneration split into vested and unvested portions;

d) the amounts of deferred remuneration awarder during the financial year paid out and reduced through performance adjustments;

e) new sign-on and severance payments made during the financial year, and the number of beneficiaries of such payments; and

f) the amounts of severance payments awarded during the financial year, the number of beneficiaries and highest such award to a single person.