II

(Preparatory Acts)

COMMISSION

Amended proposal for a Council Directive on capital adequacy of investment firms and credit institutions (1)

(92/C 50/05)

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(Submitted by the Commission pursuant to Article 149 (3) of the EEC Treaty on 27 January 1992)

Scope

Article 1

1. Member States shall apply the requirements of this Directive to investment firms and credit institutions as defined in Article 2.

2. A Member State may impose additional or more stringent requirements on the investment firms and credit institutions that it has authorized.

Definitions

Article 2

For the purpose of this Directive:

(a) *'credit institutions'* shall mean all institutions meeting the definition in the first indent of Article 1 of Directive 77/780/EEC (2)which are subject to the requirements arising from Directive 89/647/EEC (3);

(b) *'investment firms'* shall mean all institutions meeting the definition in Directive ../.../EEC (on investment services), excluding:

— credit institutions as defined above,

— local firms as defined below, and

— investment firms engaged purely in the business of supplying investment advice and/or the reception and transmission of investors' orders without holding money and/or securities on their behalf;

(c) *'firms'* shall mean credit institutions and investment firms as defined above;

(d) *'investment service'* shall mean a service included in Section A of the Annex to Directive ../.../EEC (on investment services);

(e) *'financial instruments'* shall mean the instruments set out in Section B of the Annex to Directive ../.../EEC (on investment services);

(f) the *'trading book'* of an investment firm or a credit institution shall include those positions it has taken on in the course of providing investment services associated with financial instruments, and entering into the agreements defined in (n) and (o) below. It shall therefore include its proprietary positions in financial instruments which are held for resale, or which are taken on by the investment firm or the credit institution with the intention of benefiting in the short term from actual or expected differences between their buying and selling prices, or in order to hedge other elements of the trading book, and those other exposures which are directly related to both the provision of investment services in financial instruments and points (n) and (o) below.

Inclusion or exclusion of items in, or from, the trading book shall be in accordance with objective procedures including, where appropriate, accounting standards in the firm concerned, such procedures and their consistent implementation being subject to review by the competent authorities;

(1) OJ No C 152, 21. 6. 1990, p. 6.
(2) OJ No L 322, 17. 12. 1977, p. 30.
(3) OJ No L 386, 30. 12. 1989, p. 14.

(g) *zone A, zone B, zone A credit institutions, zone B credit institutions, non-bank sector* and *multilateral development banks* shall be defined in accordance with Article 2 of Directive 89/647/EEC;

(h) *over-the-counter (OTC) derivative instruments* shall mean interest-rate and foreign-exchange contracts as set out in Annex III to Directive 89/647/EEC and off-balance-sheet contracts based on equities, provided that (i) all such contracts are not traded on recognized exchanges where they are subject to daily margin requirements, and (ii), in the case of foreign-exchange contracts, they have an original maturity of more than 14 calendar days;

(i) *qualifying items* shall mean long and short positions in assets referred to in Article 6 (1) (b) of Directive 89/647/EEC; it shall also mean long and short positions in debt securities if such securities meet the following conditions: the securities shall both be listed on at least one stock exchange in a Member State, or on a stock exchange in a third country provided that this exchange is recognized by the competent authorities of the relevant Member State, and be considered by the firm concerned to be subject to a degree of default risk which is comparable to, or lower than, that of the assets referred to in Article 6 (1) (b) of Directive 89/647/EEC.

The manner in which the securities are assessed as qualifying items or not shall be subject to scrutiny by the competent authorities, which shall overturn the judgment of the firm if they consider that the securities concerned are subject to too high a degree of default risk to be qualifying items.

Notwithstanding the above, the competent authorities shall have the discretion to deem securities which are rated by at least two credit-rating agencies recognized by the competent authorities, or by only one such credit-rating agency so long as they are not rated below such a level by any other rating agency recognized by the competent authorities, at a level which signifies that they are subject to a degree of default risk, which is comparable to, or lower than, that of the assets referred to in Article 6 (1) (b) of Directive 89/647/EEC and which are as liquid as the qualifying items defined in the previous paragraph, to be qualifying items;

(j) *central government items* shall mean long and short positions in the assets referred to in Article 6 (1) (a) and those assigned a weight of 0 % in Article 7, of Directive 89/647/EEC;

(k) *convertible* shall mean a security which, at the option of the holder, can be exchanged for another security, usually the equity of the issuer;

(l) *warrant* shall mean an instrument issued by the issuer of the underlying security, which gives the holder the right to purchase a number of shares of common stock, or bonds, at a stipulated price until the warrant's expiration date;

(m) *covered warrant* shall mean an instrument issued by an entity other than the issuer of the underlying security, which gives the holder the right to purchase a number of shares of common stock, or bonds, at a stipulated price until the warrant's expiration date;

(n) *repurchase agreement* and *reverse repurchase agreement* shall mean an agreement in which a firm transfers securities subject to a commitment to repurchase them (or substituted securities of the same description) at a specified price and a future date specified, or to be specified, by the transferor, being a 'repurchase agreement' for the firm selling the securities and a 'reverse repurchase agreement' for the firm buying them;

(o) *securities lending agreement* and *securities borrowing agreement* shall mean an agreement in which a firm lends securities and takes collateral against them subject to a commitment ot take them (or substituted securities of the same description) back and return the collateral at a specified price and at a future date specified, or to be specified, by the lender, being a securities lending agreement for the firm lending the securities and a securities borrowing agreement for the firm borrowing them;

(p) *clearing member* shall mean a member of the exchange and/or the clearing house, having a direct contractual relationship with the central counterparty (market guarantor); non-clearing members must have their trades routed through a clearing member;

(q) *local firm* shall mean a firm dealing only for its own account on a financial futures or options exchange or for the accounts of, or making a price to, other members of the same exchange. Responsibility for ensuring the performance of contracts entered into by such a firm must be assumed by a clearing member of the same exchange, and such contracts must be taken into account in the calculation of the clearing member's overall capital requirements:

(r) *delta* shall mean the expected change in an option price as a proportion of a small change in the price of the instrument underlying the option;

(s) for the purposes of paragraph 4 of Annex I, *long position* shall mean a position in which a firm has fixed the interest rate it will receive at some time in the future and *short position* shall mean a position in which it has fixed the interest rate it will pay at some time in the future;

(t) *own funds* shall mean own funds as defined in Directive 89/299/EEC. However, this definition may be modified, in the circumstances described in Annex V;

(u) *initial capital* shall mean items (1) and (2) of paragraph 1 of Article 2 of Directive 89/299/EEC [1];

(v) *original own funds* shall mean items (1), (2) and (4) minus (9), (10) and (11) of paragraph 1 of Article 2 of Directive 89/299/EEC;

(w) *capital* shall mean own funds;

(x) *modified duration* shall be calculated using the formula described in paragraph 25 of Annex I.

Initial capital for investment firms

Article 3

1. Investment firms which hold clients' money and/or securities and which offer one or more of the following services shall have initial capital of ECU 100 000:

— the reception and transmission of investors' orders for financial instruments,

— the execution of investors' orders for financial instruments,

— the management of individual portfolios of investments in financial instruments,

provided that they do not deal in any financial instruments for their own account or underwrite issues of financial instruments on a firm commitment basis.

2. However, the competent authorities may require that an investment firm which executes investors' orders for financial instruments and holds such instruments for its own account shall have initial capital of ECU 100 000 rather than be subject to the level set in paragraph 4 below, if:

— such positions arise only as a result of its failure precisely to match investors' orders, and

— the total market value of all such positions is subject to a ceiling of 25 % of the investment firm's own funds, and

— the investment firm meets the capital requirements set out in this Directive, and

— such positions are incidental and provisional in nature and strictly limited to the time required to carry out the transaction in question.

3. Member States may reduce this amount to ECU 50 000 where an investment firm is not authorized to hold clients' money or securities, nor to deal as a principal, nor to underwrite except where the firm is involved only in the distribution of issues on a best efforts basis.

4. All other investment firms shall have initial capital of ECU 500 000.

5. Each investment firm shall calculate its capital requirement under Annex IV hereto. Its own funds shall not fall below whichever is the higher of this amount and the level of initial capital laid down for the firm in paragraphs 1 to 4 above.

(1) OJ No L 124, 5. 5. 1989, p. 16.

6. Notwithstanding paragraph 5, Member States may continue the authorization of investment firms in existence before this Directive is implemented whose own funds are less than the initial capital levels specified for them in paragraph 5. The own funds of such investment firms shall not fall below the highest reference level calculated after the date of notification of this Directive. The reference level shall be the average daily level of own funds calculated over a six-month period preceding the date of calculation. This reference level shall be calculated every six months in respect of the corresponding preceding period.

7. If control of an investment firm falling within paragraph 6 is taken, other than through inheritance, by a natural or legal person other than the person who controlled it previously, the own funds of that investment firm must attain at least the level specified in paragraph 5.

8. Nevertheless, in certain specific circumstances and with the consent of the competent authorities, where there is a merger of two or more investment firms, the own funds of the investment firm resulting from the merger need not attain the level specified in paragraph 5. However, during a period when the levels referred to in paragraph 5 have not been attained, the own funds of the new investment firm may not fall below the total own funds of the merged investment firms at the time of the merger.

9. An investment firm's own funds may not fall below the level specified for it under paragraphs 5, 6, 7 and 8. However, if they do, the competent authorities may, where the circumstances justify it, allow an investment firm a limited period in which to rectify its situation or cease its activities.

Provisions against risks

Article 4

1. Firms' own funds requirements shall be the sum of:

(i) the capital requirement, calculated in accordance with Annexes I, II and VI hereto, on their trading book business;

(ii) the capital requirement, calculated in accordance with Annex III hereto, on their overall business;

(iii) the capital requirement set out in Directive 89/647/EEC on all of their non-trading book business, with the exception of the illiquid assets of those investment firms applying the definition of own funds set out in paragraph 2 of Annex V;

(iv) the capital requirement set out under paragraph 2 below;

(v) irrespective of the requirements calculated in (i) to (iii) above the own funds requirement for investment firms shall never be less than the requirement set in Annex IV.

2. The competent authorities shall require firms to cover the risks arising in connection with business that is outside the scope of both this Directive and Directive 89/647/EEC by adequate own funds.

3. The competent authorities shall require firms to set up systems to monitor and control the interest-rate risk on all of their business, these systems being subject to approval by the competent authorities.

4. Firms shall be required to satisfy their competent authorities that they have adequate systems to calculate with reasonable accuracy at any time the financial position of the firm.

5. Notwithstanding paragraph 1 above, the competent authorities may allow firms to calculate the capital requirements for their trading book business according to Directive 89/647/EEC rather than according to Annexes I, II, IV and VI below, provided that:

(i) the trading book business of these credit institutions and investment firms does not normally exceed 5 % of their total business;

(ii) their total trading book position does not normally exceed the amount of ECU 15 million.

6. In order to calculate the share of trading book business compared to total business in paragraph 5 (i) above, the competent authorities may refer either to the size of the combined on-, and off-, balance sheet business, or to the profit and loss account, or to the own funds, of the firms in question, or to a combination of these measures. In assessing the size of on-, and off-, balance sheet business, fixed-rate securities shall be valued at their market price or their principal value, equities at their market price and derivatives according to the nominal, or market, value of the instruments underlying them.

7. If a credit institution or investment firm should happen to exceed for more than a short period of time, either, or both, of the limits set in paragraph 5, it shall be required to meet the requirements set out in paragraph 1 above, and not those of Directive 89/647/EEC, in respect of its trading book business, and to notify the supervisory authority.

Valuation of positions for reporting purposes

Article 5

1. Firms shall mark to market their trading books on a daily basis, unless they are subject to the provisions of Article 4 (5).

2. In the absence of readily available market prices, e.g. in the case of dealing in new issues on the primary markets, the authorities may waive the requirement under paragraph 1 and require firms to use alternative methods of valuation provided that these methods are sufficiently prudent and have been approved by competent authorities.

Supervision on a consolidated basis

Article 6

1. Paragraphs 2 and 3 shall apply when one of the firms included within the scope of the consolidation required under Directive ../.../EEC (supervision on a consolidated basis) has a trading book.

2. The competent authorities may permit net positions in the trading book of one firm to offset positions in the trading book of another firm according to the rules set out in Annexes I and VI below, providing that each of the firms concerned is obliged to meet its capital requirements on a solo basis.

In addition they may allow foreign exchange positions subject to Annex III in one firm to offset foreign exchange positions subject to Annex III, in another firm, according to the rules set out in Annex III, providing that each of the firms concerned are obliged to meet their capital requirements on a solo basis.

3. The competent authorities charged with exercising supervision on a consolidated basis may recognize the validity of the specific own funds definitions applicable to the firms concerned under Annex V in the calculation of their consolidated own funds.

Reporting requirements

Article 7

1. Member States shall require that firms provide the competent authorities of the home Member State with all the information necessary to assess their compliance with the rules adopted in accordance with this Directive. Member States shall also ensure that firms' internal control mechanisms and administrative and accounting procedures permit the verification of their compliance with such rules at all times.

2. Investment firms shall be obliged to report to the competent authorities in the manner specified by the latter at least once every month in the case of firms covered by Article 3 (4) above, at least once every three months in the case of those firms covered by Article 3 (1) and 3 (2), and at least every six months in the case of those firms covered by Article 3 (3).

3. Credit institutions shall be obliged to report in the manner specified by the competent authorities with the same frequency as they are obliged to report under Directive 89/647/EEC.

Competent authorities

Article 8

1. Member States shall designate the authorities which are to carry out the duties provided for in this Directive. They shall inform the Commission thereof, indicating any division of duties.

2. The authorities referred to in paragraph 1 must be public authorities or bodies officially recognized by national law or by public authorities to be part of the supervisory system prevailing in the relevant Member State.

3. The authorities concerned must be granted all the powers necessary to carry out their tasks, in particular that of overseeing how the trading book is constituted.

4. The competent authorities of different Member States shall collaborate closely to carry out the duties provided for in this Directive, particularly when investment services are provided on a services basis or by the establishment of branches in one or more Member States. They shall supply one another on request with all information likely to facilitate the supervision of the capital adequacy of firms and particularly the verification of their compliance with the rules laid down in this Directive. Any exchange of information between competent authorities which is provided for in this Directive in respect of investment firms shall be subject to the obligation of professional secrecy as set out in Article 20 of Directive ../.../EEC (on investment services) and, in respect of credit institutions, subject to the obligation set out in Article 12 of Council Directive 77/780/EEC, as modified by Council Directive 89/646/EEC (1).

Article 9

1. The technical modifications to be made to this Directive in the following areas shall be adopted in accordance with the procedure laid down in paragraph 2:

— clarification of the definitions in Article 2 in order to ensure uniform application of this Directive throughout the Community,

— modification of the definitions in Article 2 to take account of developments on financial markets,

— alteration of the amounts of initial capital prescribed in Article 3 to take account of developments in the economic and monetary field,

— adaptation of the ceilings referred to in Article 4 (5),

— adaptation of the procedures for calculating net open positions in Annexes I and III,

— adaptation of the weightings in Annexes I, II and III, in order to take account of developments on financial markets,

— modification of the time period used in Annex IV,

— the alignment of terminology on and the framing of definitions in accordance with subsequent acts on firms and related matters.

2. The Commission shall be assisted by a committee composed of representatives of the Member States and chaired by a representative of the Commission.

The Commission representative shall submit to the committee a draft of the measures to be taken. The committee shall deliver its opinion on the draft within a time limit which the chairman may lay down according to the urgency of the matter. The opinion shall be delivered by the majority laid down in Article 148 (2) of the EEC Treaty in the case of decisions which the Council is required to adopt on a proposal from the Commission. The votes of the representatives of the Member States in the committee shall be weighted in a manner set out in that Article. The chairman shall not vote.

The Commission shall adopt the measures envisaged if they are in accordance with the opinion of the committee.

If the measures envisaged are not in accordance with the opinion of the committee, or if no opinion is delivered, the Commission shall, without delay, submit to the Council a proposal concerning the measures to be taken. The Council shall act by a qualified majority.

If the Council does not act within three months of the referral to it, the proposed measure shall be adopted by the Commission.

Transitional provisions

Article 10

Member States may authorize investment firms subject to Directive ../.../EEC (on investment services) whose own funds are less than the levels specified for them in paragraph 5 of Article 3 above. However, the own funds of such investment firms must thereafter meet the conditions laid down in paragraphs 6 to 9 of Article 3.

Final provisions

Article 11

1. Member States shall bring into force the laws, regulations and administrative provisions necessary to comply with this Directive by [1 January 1993] at the

(1) OJ No L 386, 30. 12. 1989, p. 1.

latest. The provisions adopted shall make express reference to this Directive. They shall forthwith inform the Commission thereof.

2. Member States shall communicate to the Commission the texts of the main provisions of national law which they adopt in the field governed by this Directive.

Article 12

This Directive is addressed to the Member States.

ANNEX I

POSITION RISK

INTRODUCTION

Netting

1. The excess of the firm's long (short) positions over its short (long) positions in the same equity, debt and convertible issues and identical financial futures, options and warrants contracts shall be its net position in each of the different instruments. In calculating the net position the competent authorities shall allow positions in derivative instruments to be treated, in the manner specified in paragraphs 4 to 6 below, as positions in the underlying (or notional) security/securities.

2. No netting shall be allowed between a convertible and an offsetting position in the instrument underlying it, unless the competent authorities adopt an approach under which the likelihood of a particular convertible being converted is taken into account or have a capital requirement to cover any potential loss which could be incurred on conversion.

3. All net positions, irrespective of their sign, must be converted on a daily basis into the firm's reporting currency at the prevailing spot exchange rate before their aggregation.

Particular instruments

4. Interest-rate futures, forward-rate agreements (FRAs) and forward commitments to buy or sell financial instruments shall be treated as combinations of long and short positions. Thus 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 the holding of an asset with a maturity date equal to that of the (notional) instrument underlying the futures contract in question. Similarly a sold FRA will be treated as a long position with a maturity date equal to the settlement date plus the contract period, and a short position with maturity equal to the settlement date. Both the borrowing and asset holding shall be included in the central government column of Table 1 in paragraph 13 in order to calculate the capital required against specific risk for these two instruments. The competent authorities may allow the capital requirement for an exchange-traded future to be equal to the margin held at the exchange if they are fully satisfied that it provides an accurate measure of the risk associated with the future and that the method used to calculate the margin is equivalent to the method of calculation set out in the rest of this Annex for such futures.

5. Options on interest rates, debt instruments, equities, equity indices, financial futures, swaps and foreign currencies shall be treated as if they were positions equal in value to the amount of the underlying instrument to which the option refers, multiplied by its delta for the purposes of this Annex. The latter positions may be netted off against any offsetting positions in the identical underlying securities or derivatives. The delta used shall be that of the exchange concerned, or that calculated by the competent authorities, or where this is not available or for OTC options, that calculated by the firm itself, subject to the competent authorities being satisfied that the model used by the firm is reasonable.

However the competent authorities may also prescribe that firms calculate their deltas using a methodology specified by the competent authorities. The competent authorities shall require that the other risks, apart from the delta risk, associated with options are safeguarded against.

6. The competent authorities may allow the requirement against a position in an exchange-traded option to be equal to the margin required by the exchange if they are fully satisfied that it provides an accurate measure of the risk associated with the option and that the method used to calculate the margin is equivalent to the method of calculation set out in the rest of this Annex for such options. In addition they may allow the requirement on a bought exchange-traded or OTC option to 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. The requirement against a written OTC option shall be set in relation to the instrument underlying it.

7. Warrants, and covered warrants, shall be treated in the same way that options are treated in paragraphs 5 and 6.

8. Swaps shall be treated for interest-rate risk purposes on the same basis as on-balance-sheet instruments. Thus an interest-rate swap under which a firm receives floating-rate interest and pays fixed-rate interest shall be treated as equivalent to 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.

9. However, firms which mark to market and manage the interest rate risk on the derivative instruments covered in paragraphs 4 to 8 on a discounted cash flow basis may use sensitivity models to calculate the positions referred to above. Both the model and its use by the firm must be approved by the competent authorities. These models should generate positions which have the same sensitivity to interest rate changes as the underlying cash flows. This sensitivity must be assessed by 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 below. The positions shall be included in the calculation of capital requirements according to the provisions laid down in paragraphs 14 to 29 below.

10. The seller of securities in a repurchase agreement, and the lender of securities in a stock lending agreement, shall include these securities in the calculation of its capital requirement under this Annex.

Specific and general risks

11. The position risk on a traded debt instrument or equity (or equity derivative) shall be divided into two components in order to calculate the capital required against it. The first shall be its specific risk component — this is the risk of a price change in the instrument concerned due to factors related to its issuer (in the case of a cash instrument). The second component shall cover its general risk — this is the risk of a price change in the instrument due (in the case of a traded debt instrument) to a change in the level of interest rates or (in the case of an equity or equity derivate) to a broad equity market movement unrelated to any specific attributes of individual securities.

TRADED DEBT INSTRUMENTS

12. The firm shall classify its net positions according to the currency in which they are denominated and shall calculate the capital requirement for general and specific risk in each individual currency separately.

Specific risk

13. The firm shall assign its net positions, as calculated in paragraph 1, to the appropriate categories in the first row of Table 1 on the basis of their residual maturities and then multiply them by the weights shown in the second row. It shall sum its weighted positions (regardless of whether they are long or short) in order to calculate its capital requirement against specific risk.

TABLE 1

Central government items	Qualifying items			Other items
	up to 6 months	over 6 and up to 24 months	over 24 months	
0,00 %	0,25 %	1,00 %	1,60 %	8,00 %

Notwithstanding the above, Member States may set a specific risk requirement for any bonds assigned a weight of 10 % in Directive 89/647/EEC by virtue of Article 11 (2) of that Directive, equal to half the specific risk requirement for a qualifying item with the same residual maturity as such a bond.

General risk

(a) *Maturity-based*

14. The procedure for calculating capital requirements against general risk involves two basic steps. First, all positions shall be weighted according to maturity (as explained in paragraph 15) in order to compute the amount of capital required against them. Second, allowance shall be made for this requirement to be reduced when a weighted position held alongside an opposite weighted position falls within the same maturity band. A reduction in the requirement shall also be allowed when the opposite weighted positions fall into different maturity bands, with the size of this reduction depending both on whether the two positions fall into the same zone, or not, and on the particular zones they fall into. There are three zones (groups of maturity bands) altogether.

15. The firm shall assign its net positions to the appropriate maturity bands in the second or third column, as appropriate, in Table 2 below. It shall do so on the basis of residual maturity in the case of fixed-rate instruments and on the basis of the period until the interest rate is next set in the case of instruments on which the interest rate is variable before final maturity. It shall also distinguish between debt instruments with a coupon of 3 % or more and those with a coupon of less than 3 % and thus allocate them to either the second or third columns in Table 2. It shall then multiply each of them by the weight presented for the maturity band in question in the fourth column of Table 2.

16. It shall then work out the sum of the weighted long positions, and the sum of the weighted short positions, in each maturity band. The amount of the former which are matched by the latter in a given maturity band shall be the matched weighted position in that band, while the residual long or short position shall be the unmatched weighted position for the same band. The total of the matched weighted positions in all bands shall then be calculated.

17. The firm shall compute the totals of the unmatched weighted long positions for the bands included in each of the zones in Table 2 in order to derive the unmatched weighted long position for each zone. Similarly, the sum of the unmatched weighted short positions for each band in a particular zone shall be summed to compute the unmatched weighted short position for that zone. That part of the unmatched weighted long position for a given zone that is matched by the unmatched weighted short position for the same zone shall be the matched weighted position for that zone. That part of the unmatched weighted long, or unmatched weighted short, position for a zone that cannot be thus matched shall be the unmatched weighted position for that zone.

TABLE 2

Zone	Maturity band		Weight (%)	Assumed interest rate exchange (%)
	Coupon of 3 % or more	Coupon of less than 3 %		
(1)	(2)	(3)	(4)	(5)
1	0— 1 month	0— 1 month	0,00	—
	1— 3 months	1— 3 months	0,20	1,00
	3— 6 months	3— 6 months	0,40	1,00
	6—12 months	6—12 months	0,70	1,00
2	1— 2 years	1,0— 1,9 years	1,25	0,90
	2— 3 years	1,9— 2,8 years	1,75	0,80
	3— 4 years	2,8— 3,6 years	2,25	0,70
3	4— 5 years	3,6— 4,3 years	2,75	0,75
	5— 7 years	4,3— 5,7 years	3,25	0,70
	7—10 years	5,7— 7,3 years	3,75	0,65
	10—15 years	7,3— 9,3 years	4,50	0,60
	15—20 years	9,3—10,6 years	5,25	0,60
	20 years	10,6—12,0 years	6,00	0,60
		12,0—20,0 years	8,40	0,60
		20 years	13,0	0,60

18. The amount of the unmatched weighted long (short) position in zone 1 which is matched by the unmatched weighted short (long) position in zone 2 shall then be computed. This shall be referred to in paragraph 22 as the matched weighted position between zones 1 and 2. The same calculation shall then be undertaken with regard to that part of the unmatched weighted position in zone 2 which is left over and the unmatched weighted position in zone 3 in order to calculate the matched weighted position between zones 2 and 3.

19. The firm may, if it wishes, reverse the order in paragraph 18 so as to calculate the matched weighted position between zones 2 and 3 before working out that between zones 1 and 2.

20. The remainder of the unmatched weighted position in zone 1 shall then be matched with what remains of that for zone 3 after that zone's matching with zone 2, in order to derive the matched weighted position between zones 1 and 3.

21. Residual positions, following the three separate matching calculations in paragraphs 18 to 20 above, shall be summed.

22. The firm's capital requirement shall be calculated as the sum of:

(a) 10 % of the sum of the matched weighted positions in all maturity bands;

(b) 30 % of the matched weighted position in zone 1;

(c) 20 % of the matched weighted position in zone 2;

(d) 20 % of the matched weighted position in zone 3;

(e) 30 % of the matched weighted position between zones 1 and 2 and between zones 2 and 3 (see paragraph 19);

(f) 100 % of the matched weighted position between zones 1 and 3;

(g) 100 % of the residual unmatched weighted positions.

(b) *Duration-based*

23. The competent authorities in a Member State may allow firms, in general or on an individual basis, to use a system for calculating the capital requirement for the general risk on traded debt instruments which reflects duration, instead of the system set out in paragraphs 14 to 22 above.

24. Under such a system the firm shall take the market value of each fixed-rate debt instrument and thence calculate its yield to maturity, which is the implied discount rate for that instrument. In the case of floating-rate instruments the firm shall take the market value of each instrument and thence calculate its yield on the assumption that the principal is due when the interest rate can next be changed.

25. The firm shall then calculate the modified duration of each debt instrument on the basis of the following formula:

$$\text{modified duration} = \frac{\text{duration (D),}}{(1 + r)}$$

where

$$D = \frac{\sum_{t=1}^{m} \frac{t \cdot C_t}{(1+r)^t}}{\sum_{t=1}^{m} \frac{C_t}{(1+r)^t}}$$

r = yield to maturity
C_t = cash payment in time t
m = total maturity (see paragraph 24).

26. It shall then allocate each of them to its appropriate zone in Table 3 below. It shall do so on the basis of the modified duration of each instrument.

TABLE 3

Zone	Modified duration (in years)	Assumed interest (% change)
(1)	(2)	(3)
1	0 < 1,0	1,0
2	1,0 < 3,6	0,85
3	3,6	0,7

27. The firm shall then calculate the duration-weighted position for each instrument by multiplying its market price by its modified duration and by the assumed interest rate change for an instrument with that particular modified duration (see third column of Table 3).

28. The firm shall work out its duration-weighted long, and its duration-weighted short, positions within each zone. The amount of the former which are matched by the latter within each zone shall be the matched duration-weighted position for that zone. The firm shall then calculate the unmatched duration-weighted positions for each zone. It shall then follow the procedures laid down for unmatched weighted positions in paragraphs 18 to 21 above.

29. The firm's capital requirement shall then be calculated as the sum of:

(a) 10 % of the matched duration-weighted position for each zone;

(b) 30 % of the matched duration-weighted position between zones 1 and 2 and between zones 2 and 3;

(c) 100 % of the matched duration-weighted position between zones 1 and 3;

(d) 100 % of the residual unmatched duration-weighted positions.

EQUITIES

30. The firm shall sum all its net — according to paragraph 1 — long positions and all its net short positions. The sum of the two figures shall be its overall gross positions. The excess of one over the other shall be its overall net position.

Specific risk

31. It shall multiply its overall gross position by 4 % in order to calculate its capital requirement against specific risk.

32. Notwithstanding paragraph 31, the competent authorities may allow the capital requirement against specific risk to be reduced to a minimum of 2 %, and not 4 %, of the overall gross position for those portfolios of equities that a firm holds which meet the following conditions. First, the equities therein shall not be those of issuers which have issued any traded debt instruments that currently attract an 8 % requirement under Table 1 above. Second, they must be adjudged highly liquid by the competent authorities concerned. Third, no individual position within such a portfolio shall comprise more than 5 % of the value of the overall gross position of the portfolio.

General risk

33. Its capital requirement against general risk shall be its overall net position multiplied by 8 %.

Stock-index futures

34. Stock-index futures, and the delta-weighted equivalents of options in stock index futures and stock indices (see paragraph 5 above) shall be broken down into positions in each of their constituent equities. These positions shall be treated as underlying positions in the equities in question; therefore, subject to the approval of the competent authorities, they shall be netted against opposite positions in the underlying equities themselves.

35. The competent authorities shall ensure that any firm which has netted off its positions in one or more of the equities constituting a stock-index future against one or more positions in the stock-index future itself has adequate capital to cover the risk of loss arising from the value of the future not moving fully in line with that of its constituent equities; they shall also do this when a firm holds opposite positions in stock-index futures which are not identical in respect of either their maturity or their composition, or both.

36. Notwithstanding paragraphs 34 and 35, stock-index futures which are exchange-traded and represent — in the opinion of the competent authorities — broadly diversified indices shall attract a capital requirement against general risk of 8 %, but no capital requirement against specific risk. Such stock-index futures shall be included in the calculation of the overall net position in paragraph 30, but disregarded in the calculation of the overall gross position in the same paragraph.

Underwriting

37. In the case of the underwriting of debt and equity instruments, the competent authorities may allow a firm to use the following procedure in calculating its capital requirements. First, it shall calculate its net positions by deducting the underwriting positions which are subscribed or reunderwritten, by third parties; second, it shall reduce its net positions by the following reduction factors:

working day 1:	90 %,
working days 2 to 3:	75 %,
working day 4:	50 %,
working day 5:	25 %,
after working day 5:	0 %.

Working day 1 shall be the working day following that on which the firm becomes unconditionally committed to accepting a known quantity of securities at an agreed price under the terms of the underwriting agreement. Third, it shall calculate its capital requirement using the reduced underwriting positions.

ANNEX II

SETTLEMENT AND COUNTERPARTY RISK

1. In the case of transactions in which bonds and equities (excluding repurchase and reverse repurchase agreements) are unsettled before their due delivery dates, there shall be no capital requirement. In the case of transactions in which bonds and equities (excluding repurchase and reverse repurchase agreements) are unsettled after their due delivery dates, a firm must calculate the price difference to which it is exposed. This is the difference between the agreed settlement price for the bond or equity in question and its current market value, where the difference could involve a loss for the firm. It must multiply this difference by the appropriate factor in Column A of Table 1 in order to calculate its capital requirement.

2. Notwithstanding paragraph 1, a firm may, at the discretion of its competent authorities, calculate its capital requirements by multiplying the agreed settlement price of every transaction which is unsettled between 5 and 45 working days after its due date by the appropriate factor in Column B of Table 1. As from 46 working days after the due date it shall take the requirement to be 100 % of the price difference to which it is exposed, as in Column A.

TABLE 1

Number of days after due settlement date	Column A (%)	Column B (%)
5—15	8	0,5
16—30	50	4,0
31—45	75	9,0
46 or more	100	See paragraph 2

Free deliveries

3. A firm shall be required to hold capital against counterparty risk if:

   (i) it has paid for securities before receiving them or it has delivered securities before receiving payment for them; and

   (ii) three days or more have elapsed since it made this payment or delivery. Thereafter a credit institution, or an investment firm which is not subject to the illiquid assets deduction in paragraph 2 of Annex V, shall be required to hold 8 % of the value of the securities or cash owed it as capital where the counterparty is in the private sector but not a firm, 1,6 % of the sum where it is a firm or in the public sector, and 0 % if it is the central government. An investment firm which is subject to the illiquid assets deduction in paragraph 2 of Annex V shall treat the value of the securities of cash owed as an illiquid asset.

Repurchase agreements

4. In the case of repurchase and securities lending agreements the firm shall calculate the difference between the market value of the securities and the amount borrowed by the firm or the market value of the collateral, where this difference is positive. In the case of reverse repurchase and securities borrowing agreements the firm shall calculate the difference between the amount the firm has lent or

the market value of the collateral and the market value of the securities it has received, where this difference is positive. The competent authorities may allow margin provided by the borrower to the lender to be taken account of in the calculations described in the previous two sentences. Accrued interest shall be included in calculating the market value of amounts lent or borrowed and collateral.

5. The capital requirement shall be 8 % of the figure emerging from paragraph 4 where the counterparty is in the private sector but not a credit institution or an investment firm, 1,6 % of the sum where it is a credit institution, an investment firm or in the public sector and 0 % if it is the central government.

OTC derivative instruments

6. In order to calculate the capital requirement on their OTC derivative instruments, the firm shall apply Annex II of Directive 89/647/EEC in the case of interest-rate, and exchange-rate, contracts; OTC equity options and covered warrants shall be dealt with under Method 1 of Annex II of Directive 89/647/EEC, except that the potential future credit exposure shall be calculated by multiplying the market value of the underlying equity by 8 %.

Other

7. The requirements of Directive 89/647/EEC shall apply to other trading book exposures including fees and commission income due, which are not covered in Annexes I and II above.

ANNEX III

FOREIGN-EXCHANGE RISK

1. If the firm's overall net foreign-exchange position, calculated in accordance with the procedure set out below, exceeds 2 % of its total own funds, it shall multiply the excess by 8 % in order to calculate its own funds requirement against foreign exchange risk.

2. A two-stage calculation shall be used.

3. First, the firm's net open currency position in each currency (including the reporting currency) shall be calculated. This position shall consist of the addition of the following elements (positive or negative):

— the net spot position (i. e. all asset items less all liability items, including accrued interest, in the currency in question),

— the net forward position (i. e. all amounts to be received less all amounts to be paid under forward exchange transactions, including currency futures and the principal on currency swaps not included in the spot position),

— irrevocable guarantees (and similar instruments) that are certain to be called,

— net future income/expenses not yet accrued but already fully hedged (at the discretion of the reporting institutions and with the prior consent of the competent authorities, net future income/expenses not yet registered in the accounting records but already fully hedged by forward foreign-exchange transactions may be included here. Such discretion must be exercised on a consistent basis),

— the net delta (or delta-based) equivalent of the total book of foreign currency options,

— the market value of other (i. e. non-foreign currency) options,

— any position which a firm has deliberately taken in order to hedge against the adverse effect of the exchange rate on its capital ratio may be excluded from the calculation of net open currency positions. Such positions should be of a non-trading or structural nature and their exclusion, and any variation of the terms of their exclusion, shall require the consent of the competent authorities. The same treatment subject to the same conditions as above may be applied to positions which a firm has which relate to items that are already deducted in the calculation of own funds.

4. Second, net short and long positions in each currency other than the reporting currency shall be converted at spot rates into the reporting currency. They shall then be summed separately to form the total of the net short positions and the total of the net long positions respectively. The higher of these two totals shall be the firm's overall net foreign-exchange position.

5. Net positions in composite currencies may be broken down into the component currencies according to the quotas in force.

ANNEX IV

OTHER RISKS

Investment firms shall be required to hold own funds equivalent to one quarter of their previous year's fixed overheads. The competent authorities may adjust this requirement in the event of a material change to such a firm's business since the previous year. When the investment firm has not completed a year's business, including on the day it starts up, the requirement shall be a quarter of the fixed overheads figure projected in its business plan, unless an adjustment to this plan is required by the authorities.

ANNEX V

OWN FUNDS

1. The own funds of investment firms and credit institutions shall be defined in accordance with Directive 89/299/EEC.

2. Notwithstanding paragraph 1, the competent authorities may permit those firms which are obliged to meet the own funds requirements that are laid down in Annexes I, II, IV and VI, or any combination of them, to use an alternative definition of own funds when meeting these requirements only. No part of the own funds thus provided may be used simultaneously to meet other own funds requirements. This alternative definition shall include items (1) to (3) for credit institutions, and items (1) to (3) minus item (4) for investment firms:

   (1) own funds as defined in Directive 89/299/EEC excluding for investment firms only items (12) and (13) of Article 2, paragraph 1 of Directive 89/299/EEC;

   (2) firms' net trading book profits or losses net of any foreseeable charges or dividends, less net losses on their other business, provided that none of these amounts have already been included in item (1) above under items (2) or (11) of Article 2, paragraph 1 of Directive 89/299/EEC;

(3) subordinated loan capital and/or the items referred to in paragraph 5 below, subject to the conditions set out in paragraph 3 to 7 below;

(4) illiquid assets as defined in paragraph 7 below.

3. The subordinated loan capital referred to in item (3) of paragraph 2 shall have an original maturity of at least two years. It shall be fully paid-up and the loan agreement shall not include any clause providing that, in specified circumstances, other than the winding-up of the firm, the debt will become repayable before the agreed repayment date, unless the competent authorities approve the repayment. This subordinated loan capital may not be repaid if such repayment would mean that the own funds of the firm in question would then stand at below 100 % of the firm's overall requirement.

4. The subordinated loan capital referred to in item (3) of paragraph 2 may not exceed a maximum of 150 % of the original own funds used to meet the requirements laid down in Annexes I, II, IV and VI under item (1) of paragraph 2 above.

5. The competent authorities may permit firms to substitute the subordinated loan capital referred to in paragraphs 3 and 4 with items (3), (5), (6) and (8) of paragraph 1 of Article 2 of Directive 89/299/EEC.

6. The competent authorities may permit the ceiling set for subordinated loan capital in paragraph 4 to exceed 150 % provided that the total of such subordinated loan capital and the items referred to in paragraph 5 does not exceed 250 % of the original own funds left to meet the requirements laid down in Annexes I, II, IV and VI under item (1) of paragraph 2.

7. Illiquid assets include:

— fixed assets (except to the extent that land and buildings may be allowed to count against the loans which they are securing),

— physical stocks,

— holdings in, including subordinated claims on, other financial institutions which may be included in the own funds of such institutions.

  Where shares in another financial institution are held temporarily for the purposes of a financial assistance operation designed to reorganize and save that institution, the competent authorities may waive this provision. They may also waive it in respect of those shares which are included in the investment firm's trading book,

— deficiencies in subsidiaries,

— deposits made, other than those which are with a credit institution, local authority or regional government and available for repayment within 90 days, and also excluding payments in connection with margined futures or options contracts,

— loans, unless they are due to be repaid within 90 days,

— amounts specified in paragraph 3 (ii) of Annex II.

ANNEX VI

LARGE EXPOSURES

1. Firms shall monitor and control their large exposures in accordance with the methods laid down in Directive . ./. . ./EEC (large exposures (LED)).

2. Notwithstanding paragraph 1 above, those firms which do not calculate the capital requirements on their trading books according to Directive 89/647/EEC, shall monitor and control the large exposures according to paragraphs 3 to 5 below, rather than in the manner set out in Directive . ./. . ./EEC (LED).

3. First they shall calculate their exposures to individual clients, or groups of connected clients, which arise on their trading book. These exposures shall be calculated by summing items (i) to (iii) below:

   (i) the market value of all net long positions in financial instruments, issued by the client, or group of connected clients, in question;

   (ii) the exposures on their contracts with the client, or group of connected clients, in OTC derivative instruments; these exposures shall be calculated by summing the current replacement cost and potential future credit exposure of interest-rate and exchange-rate contracts for firms applying method I of Annex II to Directive 89/647/EEC in Annex II above, and the original exposure in such contracts for firms applying method 2 instead. The exposure for equity options and covered warrants shall be computed by adding their replacement cost to 8 % of the market value of the equities underlying them.

   (iii) in the case of the underwriting of a debt or an equity instrument, the firm's exposures shall be its net position (which is calculated by deducting those underwriting positions which are subscribed, or sub-underwritten, by third parties) reduced by the reduction factors set out in paragraph 37 of Annex 1.

4. Notwithstanding paragraph 3 firms may exclude from their trading book exposures to clients or groups of connected clients any of the exposures included in (i), (ii) and (iii) of paragraph 3 which are also included in points (a) to (b) of paragraph 8 of Article 4 of Directive . ./. . ./EEC (LED).

5. They shall then calculate the exposures to individual clients or groups of connected clients which arise on their non-trading book business. In order to do so, investment firms shall take the exposure arising from assets which are deducted from their own funds by virtue of paragraph 2 of Annex V, to be zero. All firms' exposures which arise outside their trading book, shall be monitored and controlled in accordance with Directive (LED).

6. If the sum of a firm's trading book, and non-trading book, exposures to an individual client, or group of connected clients, exceeds 25 % of its total own funds, the firm shall meet an additional capital requirement on that part of the excess which is matched or exceeded, by the trading book exposure to the client, or group of clients, in question. In the case of the debt securities, and fixed interest rate derivatives, components, this addition will be equivalent to 100 % of the weighted position as calculated in paragraphs 13, and 15 or 28, of Annex I; in the case of the equities component it shall be 100 % of the requirement calculated under paragraphs 31 to 33 of Annex I, while in all other cases it will be 100 % of the requirement on the position *per se*. These additional capital requirements will be doubled when the total exposure concerned amounts to 50 % or more of the firm's capital.