

COUNCIL DIRECTIVE

of 18 December 1989

on a solvency ratio for credit institutions

(89/647/EEC)

THE COUNCIL OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Economic Community, and in particular the first and third sentences of Article 57 (2) thereof,

Having regard to the proposal from the Commission ⁽¹⁾,

In cooperation with the European Parliament ⁽²⁾,

Having regard to the opinion of the Economic and Social Committee ⁽³⁾,

Whereas this Directive is the outcome of work carried out by the Banking Advisory Committee, which, pursuant to Article 6 (4) of Council Directive 77/780/EEC of 12 December 1977 on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions ⁽⁴⁾, as last amended by Directive 89/646/EEC ⁽⁵⁾, is responsible for making suggestions to the Commission with a view to coordinating the coefficients applicable in the Member States;

Whereas the establishment of an appropriate solvency ratio plays a central role in the supervision of credit institutions;

Whereas a ratio which weights assets and off-balance-sheet items according to the degree of credit risk is a particularly useful measure of solvency;

Whereas the development of common standards for own funds in relation to assets and off-balance-sheet items exposed to credit risk is, accordingly, an essential aspect of the harmonization necessary for the achievement of the mutual recognition of supervision techniques and thus the completion of the internal banking market;

Whereas, in that respect, this Directive must be considered in conjunction with other specific instruments also harmonizing the fundamental techniques of the supervision of credit institutions;

Whereas this Directive must also be seen as complementary to Directive 89/646/EEC, which lays out the broader framework of which this Directive is an integral part;

Whereas, in a common banking market, institutions are required to enter into direct competition with one another and whereas the adoption of common solvency standards in the form of a minimum ratio will prevent distortions of competition and strengthen the Community banking system;

Whereas this Directive provides for different weightings to be given to guarantees issued by different financial institutions; whereas the Commission accordingly undertakes to examine whether the Directive taken as a whole significantly distorts competition between credit institutions and insurance companies and, in the light of that examination, to consider whether any remedial measures are justified;

Whereas the minimum ratio provided for in this Directive reinforces the capital of credit institutions in the Community; whereas a level of 8% has been adopted following a statistical survey of capital requirements in force at the beginning of 1988;

Whereas measurement of and allowance for interest-rate, foreign-exchange and other market risks are also of great importance in the supervision of credit institutions; whereas the Commission will accordingly, in cooperation with the competent authorities of the Member States and all other bodies working towards similar ends, continue to study the techniques available; whereas it will then make appropriate proposals for the further harmonization of supervision rules relating to those risks; whereas in so doing it will keep a special watch on the possible interaction between the various banking risks and consequently pay particular attention to the consistency of the various proposals;

Whereas, in making proposals for rules for the supervision of investment services and the adequacy of the capital of entities operating in that area, the Commission will ensure that equivalent requirements are applied in respect of the level of own funds, if the same type of business is transacted and identical risks are assumed;

Whereas the specific accounting technique to be used for the calculation of solvency ratios must take account of the provisions of Council Directive 86/635/EEC of 8 December 1986 on the annual accounts and consolidated accounts of banks and other financial institutions ⁽⁶⁾, which incorporates certain adaptations of the provisions of Council Directive 83/349/EEC ⁽⁷⁾, as amended by the Act of Accession of Spain and Portugal; whereas, pending transposition of the provisions of those Directives into the national laws of the Member States, the use of a specific accounting technique for

⁽¹⁾ OJ No C 135, 25. 5. 1988, p. 2.

⁽²⁾ OJ No C 96, 17. 4. 1984, p. 86 and OJ No C 304, 4. 12. 1984.

⁽³⁾ OJ No C 337, 31. 12. 1988, p. 8.

⁽⁴⁾ OJ No L 322, 17. 12. 1977, p. 30.

⁽⁵⁾ See page 1 of this Official Journal.

⁽⁶⁾ OJ No L 372, 31. 12. 1986, p. 1.

⁽⁷⁾ OJ No L 193, 18. 7. 1983, p. 18.

the calculation of solvency ratios should be left to the discretion of the Member States;

Whereas the application of a 20% weighting to credit institutions' holdings of mortgage bonds may unsettle a national financial market on which such instruments play a preponderant role; whereas, in this case, provisional measures are taken to apply a 10% risk weighting;

Whereas technical modifications to the detailed rules laid down in this Directive may from time to time be necessary to take account of new developments in the banking sector; whereas the Commission will accordingly make such modifications as are necessary, after consulting the Banking Advisory Committee, within the limits of the implementing powers conferred on the Commission by the provisions of the Treaty; whereas that Committee will act as a 'Regulatory' Committee, according to the rules of procedure laid down in Article 2, procedure III, variant (b), of Council Decision 87/373/EEC of 13 July 1987 laying down the procedures for the exercise of implementing powers conferred on the Commission ⁽¹⁾,

HAS ADOPTED THIS DIRECTIVE:

Scope and definitions

Article 1

1. This Directive shall apply to credit institutions as defined in the first indent of Article 1 of Directive 77/780/EEC.

2. Notwithstanding paragraph 1, the Member States need not apply this Directive to credit institutions listed in Article 2 (2) of Directive 77/780/EEC.

3. A credit institution which, as defined in Article 2 (4) (a) of Directive 77/780/EEC, is affiliated to a central body in the same Member State, may be exempted from the provisions of this Directive, provided that all such affiliated credit institutions and their central bodies are included in consolidated solvency ratios in accordance with this Directive.

4. Exceptionally, and pending further harmonization of the prudential rules relating to credit, interest-rate and market risks, the Member States may exclude from the scope of this Directive any credit institution specializing in the inter-bank and public-debt markets and fulfilling, together with the central bank, the institutional function of banking-system liquidity regulator, provided that:

- the sum of its asset and off-balance-sheet items included in the 50% and 100% weightings, calculated in accordance with Article 6, must not normally exceed

10% of total assets and off-balance-sheet items and shall not in any event exceed 15% before application of the weightings,

- its main activity consists of acting as intermediary between the central bank of its Member State and the banking system,
- the competent authority applies adequate systems of supervision and control of its credit, interest-rate and market risks.

The Member States shall inform the Commission of the exemptions granted, in order to ensure that they do not result in distortions of competition. Within three years of the adoption of this Directive, the Commission shall submit to the Council a report together, where necessary, with any proposals it may consider appropriate.

Article 2

1. For the purposes of this Directive:

- 'competent authorities' shall mean the authorities defined in the fifth indent of Article 1 of Council Directive 83/350/EEC,

- 'Zone A' shall comprise all the Member States and all other countries which are full members of the Organization for Economic Cooperation and Development (OECD) and those countries which have concluded special lending arrangements with the International Monetary Fund (IMF) associated with the Fund's General Arrangements to Borrow (GAB),

- 'Zone B' shall comprise all countries not in Zone A,

- 'Zone A credit institutions' shall mean all credit institutions authorized in the Member States, in accordance with Article 3 of Directive 77/780/EEC, including their branches in third countries, and all private and public undertakings covered by the definition in the first indent of Article 1 of Directive 77/780/EEC and authorized in other Zone A countries, including their branches,

- 'Zone B credit institutions' shall mean all private and public undertakings authorized outside Zone A covered by the definition in the first indent of Article 1 of Directive 77/780/EEC, including their branches within the Community,

- 'non-bank sector' shall mean all borrowers other than credit institutions as defined in the fourth and fifth indents, central governments and central banks, regional governments and local authorities, the European Communities, the European Investment Bank and multilateral development banks as defined in the seventh indent,

- 'multilateral development banks' shall mean the International Bank for Reconstruction and Development, the International Finance Corporation, the Inter-American Development Bank, the Asian Development Bank, the African Development Bank, the

⁽¹⁾ OJ No L 197, 18. 7. 1987, p. 33.

Council of Europe Resettlement Fund, the Nordic Investment Bank and the Caribbean Development Bank,

— 'full-risk', 'medium-risk', 'medium/low-risk' and 'low-risk' off-balance-sheet items shall mean the items described in Article 6 (2) and listed in Annex I.

2. For the purposes of Article 6 (1) (b), the competent authorities may include within the concept of regional governments and local authorities non-commercial administrative bodies responsible to regional governments or local authorities, and those non-commercial undertakings owned by central governments, regional governments, local authorities or authorities which, in the view of the competent authorities, exercise the same responsibilities as regional and local authorities.

Article 3

General principles

1. The solvency ratio referred to in paragraphs 2 to 7 expresses own funds, as defined in Article 4, as a proportion of total assets and off-balance-sheet items, risk-adjusted in accordance with Article 5.

2. The solvency ratios of credit institutions which are neither parent undertakings as defined in Article 1 of Directive 83/349/EEC nor subsidiaries of such undertakings shall be calculated on an individual basis.

3. The solvency ratios of credit institutions which are parent undertakings shall be calculated on a consolidated basis in accordance with the methods laid down in this Directive and in Directives 83/350/EEC and 86/635/EEC (1).

4. The competent authorities responsible for authorizing and supervising a parent undertaking which is a credit institution may also require the calculation of a subconsolidated or unconsolidated ratio in respect of that parent undertaking and of any of its subsidiaries which are subject to authorization and supervision by them. Where such monitoring of the satisfactory allocation of capital within a banking group is not carried out, other measures must be taken to attain that end.

5. Where the subsidiary of a parent undertaking has been authorized and is situated in another Member State, the competent authorities which granted that authorization shall require the calculation of a subconsolidated or unconsolidated ratio.

6. Notwithstanding paragraph 5, the competent authorities responsible for authorizing the subsidiary of a parent undertaking situated in another Member State may, by way of a bilateral agreement, delegate their responsibility for supervising solvency to the competent authorities which have authorized and which supervise the parent undertaking

so that they assume responsibility for supervising the subsidiary in accordance with this Directive. The Commission shall be kept informed of the existence and content of such agreements. It shall forward such information to the other authorities and to the Banking Advisory Committee.

7. Without prejudice to credit institutions' compliance with the requirements of paragraphs 2 to 6, the competent authorities shall ensure that ratios are calculated not less than twice each year, either by credit institutions themselves, which shall communicate the results and any component data required to the competent authorities, or by the competent authorities, using data supplied by the credit institutions.

8. The valuation of assets and off-balance-sheet items shall be effected in accordance with Directive 86/635/EEC. Pending implementation of the provisions of that Directive, valuation shall be left to the discretion of the Member States.

Article 4

The numerator: own funds

Own funds as defined in Directive 89/299/EEC (2) shall form the numerator of the solvency ratio.

Article 5

The denominator: risk-adjusted assets and off-balance-sheet items

1. Degrees of credit risk, expressed as percentage weightings, shall be assigned to asset items in accordance with Articles 6 and 7, and exceptionally Articles 8 and 11. The balance-sheet value of each asset shall then be multiplied by the relevant weighting to produce a risk-adjusted value.

2. In the case of the off-balance-sheet items listed in Annex I, a two-stage calculation as prescribed in Article 6 (2) shall be used.

3. In the case of the interest-rate- and foreign-exchange-related off-balance-sheet items referred to in Article 6 (3), the potential costs of replacing contracts in the event of counterparty default shall be calculated by means of one of the two methods set out in Annex II. Those costs shall be multiplied by the relevant counterparty weightings in Article 6 (1), except that the 100% weightings as provided for there shall be replaced by 50% weightings to produce risk-adjusted values.

4. The total of the risk-adjusted values of the assets and off-balance-sheet items mentioned in paragraphs 2 and 3 shall be the denominator of the solvency ratio.

(1) OJ No L 372, 31. 12. 1986, p. 1.

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

Article 6

Risk weightings

1. The following weightings shall be applied to the various categories of asset items, although the competent authorities may fix higher weightings as they see fit:

(a) Zero weighting

1. cash in hand and equivalent items;
2. asset items constituting claims on Zone A central governments and central banks;
3. asset items constituting claims on the European Communities;
4. asset items constituting claims carrying the explicit guarantees of Zone A central governments and central banks;
5. asset items constituting claims on Zone B central governments and central banks, denominated and funded in the national currencies of the borrowers;
6. asset items constituting claims carrying the explicit guarantees of Zone B central governments and central banks, denominated and funded in the national currency common to the guarantor and the borrower;
7. asset items secured, to the satisfaction of the competent authorities, by collateral in the form of Zone A central government or central bank securities, or securities issued by the European Communities, or by cash deposits placed with the lending institution or by certificates of deposit or similar instruments issued by and lodged with the latter;

(b) 20 % weighting

1. asset items constituting claims on the European Investment Bank (EIB);
2. asset items constituting claims on multilateral development banks;
3. asset items constituting claims carrying the explicit guarantee of the European Investment Bank (EIB);
4. asset items constituting claims carrying the explicit guarantees of multilateral development banks;
5. asset items constituting claims on Zone A regional governments or local authorities, subject to Article 7;
6. asset items constituting claims carrying the explicit guarantees of Zone A regional governments or local authorities, subject to Article 7;
7. asset items constituting claims on Zone A credit institutions but not constituting such institutions' own funds as defined in Directive 89/299/EEC;

8. asset items constituting claims, with a maturity of one year or less, on Zone B credit institutions, other than securities issued by such institutions which are recognized as components of their own funds;

9. asset items carrying the explicit guarantees of Zone A credit institutions;

10. asset items constituting claims with a maturity of one year or less, carrying the explicit guarantees of Zone B credit institutions;

11. asset items secured, to the satisfaction of the competent authorities, by collateral in the form of securities issued by the EIB or by multilateral development banks;

12. cash items in the process of collection;

(c) 50 % weighting

1. loans fully and completely secured, to the satisfaction of the competent authorities, by mortgages on residential property which is or will be occupied or let by the borrower;

2. prepayments and accrued income: these assets shall be subject to the weighting corresponding to the counterparty where a credit institution is able to determine it in accordance with Directive 86/635/EEC. Otherwise, where it is unable to determine the counterparty, it shall apply a flat-rate weighting of 50 %;

(d) 100 % weighting

1. asset items constituting claims on Zone B central governments and central banks except where denominated and funded in the national currency of the borrower;

2. asset items constituting claims on Zone B regional governments or local authorities;

3. asset items constituting claims with a maturity of more than one year on Zone B credit institutions;

4. asset items constituting claims on the Zone A or Zone B non-bank sectors;

5. tangible assets within the meaning of assets as listed in Article 4 (10) of Directive 86/635/EEC;

6. holdings of shares, participations and other components of the own funds of other credit institutions which are not deducted from the own funds of the lending institutions;

7. all other assets except where deducted from own funds.

2. The following treatment shall apply to off-balance-sheet items other than those covered in paragraph 3. They shall first be grouped according to the risk groupings set out in Annex I. The full value of the full-risk items shall be taken into account, 50 % of the value of the medium-risk items and 20 % of the medium/low-risk items, while the value of low-risk items shall be set at zero. The

second stage shall be to multiply the off-balance-sheet values, adjusted as described above, by the weightings attributable to the relevant counterparties, in accordance with the treatment of asset items prescribed in paragraph 1 and Article 7. In the case of asset sale and repurchase agreements and outright forward purchases, the weightings shall be those attaching to the assets in question and not to the counterparties to the transactions.

3. The methods set out in Annex II shall be applied to the interest-rate and foreign-exchange risks listed in Annex III.

4. Where off-balance-sheet items carry explicit guarantees, they shall be weighted as if they had been incurred on behalf of the guarantor rather than the counterparty. Where the potential exposure arising from off-balance-sheet transactions is fully and completely secured, to the satisfaction of the competent authorities, by any of the asset items recognized as collateral in paragraph 1 (a) (7) or (b) (11), weightings of 0% or 20% shall apply, depending on the collateral in question.

5. Where asset and off-balance-sheet items are given a lower weighting because of the existence of explicit guarantees or collateral acceptable to the competent authorities, the lower weighting shall apply only to that part which is guaranteed or which is fully covered by the collateral.

Article 7

1. Notwithstanding the requirements of Article 6 (1) (b), the Member States may fix a weighting of 0% for their own regional governments and local authorities if there is no difference in risk between claims on the latter and claims on their central governments because of the revenue-raising powers of the regional governments and local authorities and the existence of specific institutional arrangements the effect of which is to reduce the chances of default by the latter. A zero weighting fixed in accordance with these criteria shall apply to claims on and off-balance-sheet items incurred on behalf of the regional governments and local authorities in question and claims on others and off-balance-sheet items incurred on behalf of others and guaranteed by those regional governments and local authorities.

2. The Member States shall notify the Commission if they believe a zero weighting to be justified according to the criteria laid down in paragraph 1. The Commission shall circulate that information. Other Member States may offer the credit institutions under the supervision of their competent authorities the possibility of applying a zero weighting where they undertake business with the regional governments or local authorities in question or where they hold claims guaranteed by the latter.

Article 8

1. The Member States may apply a weighting of 20% to asset items which are secured, to the satisfaction of the competent authorities concerned, by collateral in the form of securities issued by Zone A regional governments or local authorities, by deposits placed with Zone A credit institutions other than the lending institution, or by certificates of deposit of similar instruments issued by those credit institutions.

2. The Member States may apply a weighting of 10% to claims on institutions specializing in the inter-bank and public-debt markets in their home Member States and subject to close supervision by the competent authorities where those asset items are fully and completely secured, to the satisfaction of the competent authorities of the home Member States, by a combination of asset items mentioned in Article 6 (1) (a) and (b) recognized by the latter as constituting adequate collateral.

3. The Member States shall notify the Commission of any provisions adopted pursuant to paragraphs 1 and 2 and of the grounds for such provisions. The Commission shall forward that information to the Member States. The Commission shall periodically examine the implications of those provisions in order to ensure that they do not result in any distortions of competition. Within three years of the adoption of this Directive, the Commission shall submit to the Council a report together, where necessary, with any proposals it may consider appropriate.

Article 9

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

- a temporary reduction in the minimum ratio prescribed in Article 10 or the weightings prescribed in Article 6 in order to take account of specific circumstances,
- the definition of 'Zone A' in Article 2,
- the definition of 'multilateral development banks' in Article 2,
- amendment of the definitions of the assets listed in Article 6 in order to take account of developments on financial markets,
- the lists and classification of off-balance-sheet items in Annexes I and III and their treatment in the calculation of the ratio as described in Articles 5, 6 and 7 and Annex II,
- clarification of the definitions in order to ensure uniform application of this Directive throughout the Community,
- clarification of the definitions in order to take account in the implementation of this Directive of developments on financial markets,
- the alignment of terminology on and the framing of definitions in accordance with subsequent acts on credit institutions 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 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 the 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 Commission shall adopt the measures proposed, unless the Council has decided against those measures by a simple majority.

Article 10

1. With effect from 1 January 1993 credit institutions shall be required permanently to maintain the ratio defined in Article 3 at a level of at least 8%.

2. Notwithstanding paragraph 1, the competent authorities may prescribe higher minimum ratios as they consider appropriate.

3. If the ratio falls below 8% the competent authorities shall ensure that the credit institution in question takes appropriate measures to restore the ratio to the agreed minimum as quickly as possible.

Article 11

1. A credit institution the minimum ratio of which has not reached the 8% prescribed in Article 10 (1) by the date prescribed in Article 12 (1) must gradually approach that level by successive stages. It may not allow the ratio to fall below the level reached before that objective has been attained. Any fluctuation should be temporary and the competent authorities should be apprised of the reasons for it.

2. For not more than five years after the date prescribed in Article 10 (1) the Member States may fix a weighting of 10% for the bonds defined in Article 22 (4) of Council Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) ⁽¹⁾, as amended by Directive 88/220/EEC ⁽²⁾, and maintain it for credit institutions when and if they consider it necessary, to avoid grave disturbances in the operation of their markets. Such exceptions shall be reported to the Commission.

3. For not more than seven years after 1 January 1993, Article 10 (1) shall not apply to the Agricultural Bank of Greece. However, the latter must approach the level prescribed in Article 10 (1) by successive stages according to the method described in paragraph 1.

4. By derogation from Article 6 (1) (c) (1), until 1 January 1996 Germany, Denmark and Greece may apply a weighting of 50% to assets which are entirely and completely secured to the satisfaction of the competent authorities concerned, by mortgages on completed residential property, on offices or on multi-purpose commercial premises, situated within the territories of those three Member States provided that the sum borrowed does not exceed 60% of the value of the property in question, calculated on the basis of rigorous assessment criteria laid down in statutory or regulatory provisions.

5. Member States may apply a 50% weighting to property leasing transactions concluded within ten years of the date laid down in Article 12 (1) and concerning assets for business use situated in the country of the head office and governed by statutory provisions whereby the lessor retains full ownership of the rented asset until the tenant exercises his option to purchase.

Article 12

1. The Member States shall adopt the measures necessary for them to comply with the provisions of this Directive by 1 January 1991 at the latest.

2. The Member States shall communicate to the Commission the texts of the main laws, regulations and administrative provisions which they adopt in the field covered by this Directive.

Article 13

This Directive is addressed to the Member States.

Done at Brussels, 18 December 1989.

For the Council
The President
P. BÉRÉGOVOY

⁽¹⁾ OJ No L 375, 31. 12. 1985, p. 3.

⁽²⁾ OJ No L 100, 19. 4. 1988, p. 31.

ANNEX I

CLASSIFICATION OF OFF-BALANCE-SHEET ITEMS

Full risk

- Guarantees having the character of credit substitutes,
- Acceptances,
- Endorsements on bills not bearing the name of another credit institution,
- Transactions with recourse,
- Irrevocable standby letters of credit having the character of credit substitutes,
- Asset sale and repurchase agreements as defined in Articles 12 (1) and (2) of Directive 86/635/EEC, if these agreements are treated as off-balance-sheet items pending application of Directive 86/635/EEC,
- Assets purchased under outright forward purchase agreements,
- Forward forward deposits,
- The unpaid portion of partly-paid shares and securities,
- Other items also carrying full risk.

Medium risk

- Documentary credits issued and confirmed (see also medium/low risk),
- Warranties and indemnities (including tender, performance, customs and tax bonds) and guarantees not having the character of credit substitutes,
- Asset sale and repurchase agreements as defined in Article 12 (3) and (5) of Directive 86/635/EEC,
- Irrevocable standby letters of credit not having the character of credit substitutes,
- Undrawn credit facilities (agreements to lend, purchase securities, provide guarantees or acceptance facilities) with an original maturity of more than one year,
- Note issuance facilities (NIFs) and revolving underwriting facilities (RUFs),
- Other items also carrying medium risk.

Medium/low risk

- Documentary credits in which underlying shipment acts as collateral and other self-liquidating transactions,
- Other items also carrying medium/low risk.

Low risk

- Undrawn credit facilities (agreements to lend, purchase securities, provide guarantees or acceptance facilities) with an original maturity of up to and including one year or which may be cancelled unconditionally at any time without notice,
- Other items also carrying low risk.

The Member States undertake to inform the Commission as soon as they have agreed to include a new off-balance-sheet item in any of the last indents under each category of risk. Such items will be definitively classified at Community level once the procedure laid down in Article 9 has been completed.

ANNEX II

THE TREATMENT OF OFF-BALANCE-SHEET ITEMS CONCERNING INTEREST AND FOREIGN-EXCHANGE RATES

Subject to the consent of their supervisory authorities, credit institutions may choose one of the methods set out below to measure the risks associated with the transactions listed in Annex III. Interest-rate and foreign-exchange contracts traded on recognized exchanges where they are subject to daily margin requirements and foreign-exchange contracts with an original maturity of 14 calendar days or less are excluded.

Where there is a separate bilateral contract for novation, recognized by the national supervisory authorities, between a credit institution and its counterparty under which any obligation to each other to deliver payments in their common currency on a given date are automatically amalgamated with other similar obligations due on the same date, the single net amount fixed by such novation is weighted, rather than the gross amounts involved.

Method 1: the 'marking to market' approach

Step (a): by attaching current market values to contracts (marking to market) the current replacement cost of all contracts with positive values is obtained.

Step (b): to obtain a figure for potential future credit exposure⁽¹⁾, the notional principal amounts or values underlying an institution's aggregate books are multiplied by the following percentages:

Residual maturity	Interest-rate contracts	Foreign-exchange contracts
One year or less	0 %	1 %
More than one year	0,5 %	5 %

Step (c): the sum of current replacement cost and potential future credit exposure is multiplied by the risk weightings allocated to the relevant counterparties in Article 6.

Method 2: the 'original exposure' approach

Step (a): the notional principal amount of each instrument is multiplied by the percentages given below:

Original maturity ⁽¹⁾	Interest-rate contracts	Foreign-exchange contracts
One year or less	0,5 %	2 %
More than one year but not exceeding two years	1 %	5 %
Additional allowance for each additional year	1 %	3 %

⁽¹⁾ In the case of interest-rate contracts, credit institutions may, subject to the consent of their supervisory authorities, choose either original or residual maturity.

Step (b): the original exposure thus obtained is multiplied by the risk weightings allocated to the relevant counterparties in Article 6.

⁽¹⁾ Except in the case of single-currency 'floating/floating interest rate swaps' in which only the current replacement cost will be calculated.

*ANNEX III***TYPES OF OFF-BALANCE-SHEET ITEMS CONCERNING INTEREST RATES AND FOREIGN EXCHANGE****Interest-rate contracts**

- Single-currency interest rate swaps,
- Basis swaps,
- Forward-rate agreements,
- Interest-rate futures,
- Interest-rate options purchased,
- Other contracts of a similar nature.

Foreign-exchange contracts

- Cross-currency interest-rate swaps,
 - Forward foreign-exchange contracts,
 - Currency futures,
 - Currency options purchased,
 - Other contracts of a similar nature.
-