Regulatory Capital

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The structure of regulatory capital

1. Total regulatory capital will consist of the sum of the following elements:
   a. Tier 1 Capital (going-concern capital)
      i. Common Equity Tier 1
      ii. Additional Tier 1
   b. Tier 2 Capital (gone-concern capital)

Limits on the structure of capital

2. a. Tier 2 capital may not exceed 100% of Tier 1 Capital after the deductions required from that capital.
   b. Capital instruments that may be included in Tier 2 Capital may not exceed 50% of Tier 1 Capital after the deductions required from that capital. This limit does not include the capital instruments included prior to the application of this directive in upper Tier 2 Capital, up to the balance of those instruments as of 31st of December 2013 and in accordance with the transitional directives set out in Directive 299 (Regulatory Capital – Transitional Directives).

Definitions

3. **"Investment"**
   - A direct, indirect[1] and synthetic holdings of capital instruments. For example, banking corporations should look through holdings of index securities to determine their underlying holdings of capital.
   - Holdings in both the banking book and the trading book are to be included. It is the net long position that is to be included (i.e. the gross long position net of short positions) in the same underlying exposure where the maturity of the short position matches the maturity of the long position or has a residual maturity of at least one year. Offsetting long positions with short positions shall only be done if the two exposures are registered in the trading book or in the banking book.

[1] Indirect holdings are exposures or parts of exposures that, if a direct holding loses its value, will result in a loss to the banking corporation substantially equivalent to the loss in value of the direct holding.

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- Underwriting positions held for five working days or less can be excluded. Underwriting positions held for long than five working days must be included.
- If the capital instrument does not meet the criteria for Common Equity Tier 1, Additional Tier 1, or Tier 2 capital of the banking corporation in accordance with this Directive, the capital is to be considered common shares for the purposes of this definition.
- Subject to the discretion of the Supervisor of Banks, and with his prior approval, banking corporations may temporarily exclude certain investments where these have been made in the context of resolving or providing financial assistance to reorganize a distressed institution.

"Financial Corporation" – one of the following:

- A banking corporation and its subsidiaries and a foreign corporation that is a bank;
- An insurance company;
- A Credit card and settlement company;
- A mutual fund or portfolio management company;
- A provident fund or pension fund management company;
- Another company whose principal occupation is in the capital market.

Common Equity Tier 1

4. Common Equity Tier 1 capital consists of the sum of the following elements:
    a. Common shares issued by the banking corporation that meet the criteria set forth in Appendix A;
    b. A premium on the common shares included in Common Equity Tier 1 capital.
    c. Retained earnings, including dividends proposed or declared subsequent to the balance sheet date;
    d. Accumulated other comprehensive income and other disclosed reserves, including:

i. Unrealized gains or losses from fair-value adjustments of securities available for sale;
ii. Unrealized gains or losses from cash flow hedges;
iii. Foreign currency translation adjustments of autonomous units held abroad;
iv. Equity fund created from a benefit on account of share-based payment transactions;
v. Receipts on account of shares, provided that there is an irrevocable commitment to purchase and allocate them, as well as amounts received in exchange for options to purchase shares, provided that these amounts are not refundable;
vi. Other funds that have received the approval of the Supervisor of Banks.

e. Common shares issued by a subsidiary of the banking corporation that have been consolidated and are held by a third party (minority interest), where the following two conditions exist:
i. The shares giving rise to the minority interests would, if issued by the banking corporation, meet all of the criteria for classification as common shares, as detailed in Appendix A;
ii. The subsidiary that issued the shares is itself a corporation subject to the same minimum prudential standards and level of supervision as a banking corporation.

The amount of the minority interests recognized as Common Equity Tier 1 shall be calculated as detailed in Appendix B.

f. Regulatory adjustments and deductions from Common Equity Tier 1 as detailed in Section 5.

Regulatory adjustments and deductions from Common Equity Tier 1

5. a. Goodwill and all other intangibles must be deducted in the calculation of Common Equity Tier 1, including any goodwill included in the valuation of significant investments in the capital of financial corporations that are outside the scope of regulatory consolidation of the banking corporation, and including mortgage servicing rights, net of any associated deferred tax

liability which would be extinguished if the intangible assets become impaired or derecognized under the Reporting to the Public Directives. Negative goodwill should not be added to capital;

b. Deferred tax assets (DTAs) that rely on future profitability of the banking corporation may be netted with associated deferred tax liabilities (DTLs) only if the DTAs and DTLs relate to taxes levied by the same taxation authority and offsetting is permitted by the relevant taxation authority. Where these DTAs related to temporary differences, the amount to be deducted is set out in accordance with Section 13 “threshold deductions”. All other such assets, e.g. those relating to operating losses, such as the carry forward of unused tax losses, or unused tax credits, are to be deducted in full net of deferred tax liabilities as described above. The DTLs permitted to be netted against DTAs must exclude amounts that have been netted against the deduction of goodwill, intangibles and defined benefit pension assets, and must be allocated on a pro-rata basis between DTAs subject to the threshold deduction treatment and DTAs that are to be deducted in full.

c. Defined benefit pension fund that is an asset on the balance sheet, net of any associated deferred tax liability which would be extinguished if the asset should become impaired or derecognized under the Reporting to the Public Directives. Assets in the fund to which the banking corporation has unrestricted and unfettered access can, with supervisory approval, offset the deduction. Defined benefit pension fund liabilities must be fully recognized in the calculation of Common Equity Tier 1.

d. The amount of accumulated other comprehensive income on account of cash flow hedges of items that are not fair valued on the balance sheet (including projected cash flows). This means that positive amounts should be deducted and negative amounts should be added back.

e. Increase in equity capital resulting from a securitization transaction, such as that associated with expected future margin income (FMI) resulting in a gain-on-sale, in accordance with Section 562 of Proper Conduct of

Banking Business Directive 205, “Measurement and Capital Adequacy – Credit Risk – Securitization”.

f. Unrealized gains and losses that have resulted from changes in the fair value of liabilities that are due to changes in the banking corporation’s own credit risk. In addition, with regard to derivative liabilities, derecognize all accounting valuation adjustments (DVA) arising from the bank’s own credit risk. There should be no offsetting between valuation adjustments from the bank’s own credit risk and those arising from its counterparties' credit risk.

g. Shortfall of the stock of provisions to expected losses according to the IRB method in accordance with Proper Conduct of Banking Business Directive 204 “Measurement and Capital Adequacy – The Internal Ratings based (IRB) Approach to Credit Risk”. The full amount is to be deducted and should not be reduced by any tax effects that could be expected to occur if provisions were to rise to the level of expected losses.

h. Investments in own common shares (treasury stock), whether held directly or indirectly, (including any own stock which the bank could be contractually obliged to purchase). The treatment described will apply irrespective of the location of the exposure in the banking book or the trading book. In addition:
   (1) Gross long positions may be deducted net of short positions in the same underlying exposure only if the short positions involve no counterparty risk.
   (2) Banking corporations should look through holdings of index securities to deduct exposures to own shares. However, gross long positions in own shares resulting from holdings of index securities may be netted against short positions in own shares resulting from short positions in the same underlying index. In such cases the short positions may involve counterparty risk (which will be subject to the relevant counterparty credit risk charge).

i. Reciprocal cross holdings in the common shares of financial corporations.

j. Investments in the capital of financial corporations that are outside the scope of regulatory consolidation of the banking corporation as detailed in Section 6.

Investments in the capital of financial corporations

6. a. Where the banking corporation does not own more than 10% of the issued common share capital of the financial corporation:

(1) Investments that are not common shares of banking corporations and their subsidiaries must be fully deducted from the relevant capital tier as stated in Sections 8c and 11c.

(2) Investments in common shares of banking corporations and their subsidiaries, and in shares and capital instruments of other financial corporations (hereinafter – the total investments) shall be handled as follows:

Where the total investments do not exceed 10% of the banking corporation’s Common Equity Tier 1 capital (after the application of all regulatory adjustments set out in Sections 5a-j, and before this deduction), each investment shall be weighted according to the risk of each corporation.

(3) Where the total investments exceed 10% of the banking corporation’s Common Equity Tier 1 capital or where the financial corporation is an affiliated company of the banking corporation, then the amount above 10% shall be deducted from capital as follows:

(a) The amount to be deducted from Common Equity Tier 1 capital shall be calculated as the total investments exceeding 10% of the banking corporation’s Common Equity Tier 1 capital multiplied by the total investments in Common Equity Tier 1 capital of the financial corporations, divided by the total investments.

(b) The amount to be deducted from Additional Tier 1 capital shall be calculated as the total investments exceeding 10% of the banking corporation’s Common Equity Tier 1 capital multiplied by the total investments in Additional Tier 1 capital of the

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financial corporations that are not banking corporations or their subsidiaries, divided by the total investments.

(c) The amount to be deducted from Tier 2 capital shall be calculated as the total investments exceeding 10% of the banking corporation's Common Equity Tier 1 capital multiplied by the total investments in Tier 2 capital of the financial corporations that are not banking corporations or their subsidiaries, divided by the total investments.

An "**affiliated company**" for the purpose of this Section is defined as a company that controls, or is controlled by, or is under common control with, the banking corporation. Control of a company is defined as: (1) ownership, control or holding with power to vote 20% or more of a class of voting securities of the company; or (2) consolidation of the company for financial reporting purposes.

b. Where the banking corporation owns more than 10% of the issued common share capital of the financial corporation:

(1) Investments that are not common shares must be fully deducted from the relevant capital tier.

(2) Investments in common shares shall be handled as set out in Section 13 ("threshold deductions").

Additional Tier 1 Capital

7. Additional Tier 1 Capital consists of the sum of the following elements:

a. Instruments issued by the banking corporation (and are not included in Common Equity Tier 1) that meet the following requirements:

(1) Meeting the criteria for inclusion in Additional Tier 1 capital as detailed in Appendix C.

(2) Meeting the loss absorbency requirements at the point of non-viability as detailed in Appendix E.

b. Stock surplus (share premium) resulting from the issue of instruments included in Additional Tier 1 capital.

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c. Additional Tier 1 Instruments issued by consolidated subsidiaries of the banking corporation and held by third parties, where the instruments, had they been issued by the banking corporation, would meet the criteria for inclusion in Additional Tier 1 capital as detailed in Appendices C and E, and are not included in Common Equity Tier 1.
The amount of the instruments that shall be recognized as Additional Tier 1 capital will be calculated as detailed in Appendix B.

d. Deductions from Additional Tier 1 capital as detailed in Section 8.

8. **Deductions from Additional Tier 1 capital**

a. Investments in own Additional Tier 1 capital instruments, whether held directly or indirectly (including any own instruments which the bank could be contractually obliged to purchase), as detailed in Section 5h above.

b. Reciprocal cross holdings in Additional Tier 1 capital instruments of financial corporations.

c. Investments in Additional Tier 1 capital instruments of banking corporations and their subsidiaries.

d. Investments in Additional Tier 1 capital instruments of financial corporations that are outside the scope of regulatory consolidation of the banking corporation as detailed in Section 6.

9. Where the banking corporation is required to make a deduction from Additional Tier 1 capital and does not have sufficient capital in this tier, the difference will be deducted from Common Equity Tier 1.

Tier 2 capital

10. Tier 2 capital consists of the sum of the following elements:

a. Instruments issued by the banking corporation (and are not included in Tier 1 capital) that meet the following requirements:

(1) Meeting the criteria for inclusion in Tier 2 capital as detailed in Appendix D.

(2) Meeting the loss absorbency requirements at the point of non-viability as detailed in Appendix E.

(3) Sending a notification to the Banking Supervision Department, soon after issuance of the capital instrument, using the format in Appendix G, attached.

b. Stock surplus (share premium) resulting from the issue of instruments included in Tier 2 capital.

c. Tier 2 capital instruments issued by consolidated subsidiaries of the banking corporation and held by third parties, where the instruments, had they been issued by the banking corporation, would meet the criteria for inclusion in Tier 2 capital as detailed in Appendices D and E, and are not included in Tier 1 capital.

The amount of the instruments that shall be recognized as Tier 2 capital will be calculated as detailed in Appendix B.

d. Group provisions for credit losses before the effect of attributed tax. The amount of the provisions eligible to be included in Tier 2 capital shall not exceed the following limitations:

(1) 1.25% of the total credit risk-weighted risk assets calculated under the standardized approach;

(2) Where the total expected loss amount calculated under the IRB approach is less than the total eligible provisions, the difference may be recognized up to a maximum of 0.6 % of credit risk-weighted risk assets.

e. Deductions from Tier 2 capital as detailed in Section 11.

Deductions from Tier 2 capital

11. a. Investments in own Tier 2 capital instruments, whether held directly or indirectly (including any own instruments which the bank could be contractually obliged to purchase), as detailed in Section 5h above.

b. Reciprocal cross holdings in the Tier 2 capital instruments of financial corporations.

c. Investments in Tier 2 capital instruments of banking corporations and their subsidiaries.

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d. Investments in Tier 2 capital instruments of financial corporations that are outside the scope of regulatory consolidation of the banking corporation as detailed in Section 6.

12. Where the banking corporation is required to make a deduction from Tier 2 capital and does not have sufficient capital to make the required deduction, the difference will be deducted from Additional Tier 1 capital.

Threshold deductions

13. a. The following two items shall be subject to deductions as detailed in this section:
   - Deferred tax assets (DTAs) that arise from temporary differences (as stated in Section 5b).
   - Investments exceeding 10% of the issued common share capital of financial corporations (as referred to in Section 6).

   b. The amount of each of these two items that exceeds 10% of the banking corporation's Common Equity Tier 1 capital after all deductions enumerated in Section 5, but before applying the threshold deductions in this Section, shall be deducted from the banking corporation's Common Equity Tier 1 capital.

   c. Between January 1, 2014 and January 1, 2018:
   The amount of the two items that has not been deducted pursuant to sub-Section b above, that exceeds 15% of the banking corporation's Common Equity Tier 1 capital (before deducting these items but after all of the other deductions), shall be deducted from Common Equity Tier 1.

   d. As of January 1, 2018:
   (1) The amount of the two items that has not been deducted pursuant to sub-Section b above, that exceeds 15% of the banking corporation's Common Equity Tier 1 (after all of the deductions), shall be deducted from Common Equity Tier 1.

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(2) For the purpose of determining the amount of the two items recognized for Common Equity Tier 1, the total Common Equity Tier 1 (after all of the deductions including the deduction of the two items in full) must be multiplied by 17.65% (the ratio between 15% and 85%).

e. The amount of the two above items that has not been deducted from Common Equity Tier 1 will be risk weighted at 250%. An example for calculating the limitation is attached in Appendix F.

Items weighted at 1250%

14. The following items will receive a 1250% risk weight:
    (a) Certain securitization exposures, in accordance with Section 562 of Proper Conduct of Banking Business Directive 205 “Measurement and Capital Adequacy – Credit Risk – Securitization”;
    (b) Certain equity exposures under the PD/LGD approach.
    (c) Non-payment/delivery on non-DvP and non-PvP transactions;
    (d) Surplus investments of more than 5% of a banking corporation’s Common Equity Tier 1 in a single real corporation that is not a financial corporation;
    (e) Surplus investments of more than 20% of any kind of means of control in real corporations that are not financial corporations.

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Appendix A

Criteria for classification of common shares

For common shares to be included in Common Equity Tier 1 capital it must meet all of the criteria that follow:

1. They represent the most subordinated claim in liquidation of the bank.
2. They are entitled to a claim on the residual assets that is proportional with their share of issued capital, after all senior claims have been repaid in liquidation (i.e. they have an unlimited and variable claim, not a fixed or capped claim).
3. The principal is perpetual and never repaid outside of liquidation (setting aside discretionary repurchases or other means of effectively reducing capital in a discretionary manner that is allowable under relevant law).
4. The banking corporation does nothing to create an expectation at issuance that the instrument will be bought back, redeemed or cancelled nor do the statutory or contractual terms provide any feature which might give rise to such an expectation.
5. Distributions are paid only out of distributable items (retained earnings included). The level of distributions is not in any way tied or linked to the amount paid in at issuance and is not subject to a contractual cap (except to the extent that a banking corporation is unable to pay distributions that exceed the level of distributable items).
6. There are no circumstances under which the distributions are obligatory. Non-payment is therefore not an event of default.
7. Distributions are paid only after all legal and contractual obligations have been met and payments on more senior capital instruments have been made. This means that there are no preferential distributions, including in respect of other elements classified as the highest quality issued capital.
8. It is the issued capital that takes the first and proportionately greatest share of any losses as they occur. Within the highest quality capital, each instrument

absorbs losses on a going concern basis proportionately and *pari passu* with all the others.

9. The paid in amount is recognized as equity capital (i.e. not recognized as a liability) for determining balance sheet insolvency.

10. The paid in amount is classified as equity under the relevant accounting standards.

11. It is directly issued and paid in in full and the banking corporation cannot directly or indirectly have funded the purchase of the instrument.

12. The paid in amount is neither secured nor covered by a guarantee of the issuer or related entity[2] or subject to any other arrangement that legally or economically enhances the seniority of the claim.

13. It is only issued with the approval of the owners of the issuing banking corporation, either given directly by the owners or, if permitted by applicable law, given by the Board of Directors or by other persons duly authorized by the owners.

14. It is clearly and separately disclosed on the banking corporation's balance sheet.

[2] A related entity may include a parent company, a sister company, a subsidiary or any other affiliate. A holding company is a related company irrespective of whether it forms part of the consolidated banking group.

Appendix B

Minority interest and other capital issued out of consolidated subsidiaries that is held by third parties

1. The amount of minority interests that meets the requirements detailed in the Directive that may be included in regulatory capital is:
   a. the total amount of the capital attributable to third parties, less
   b. any surplus capital amount above the minimum regulatory requirements detailed in Proper Conduct of Banking Business Directive 201 (hereinafter – "surplus capital"), calculated in accordance with Sections 2-4 below.

Common Equity Tier 1

2. The amount of minority interests that will be recognized in Common Equity Tier 1 will be calculated as follows:
   a. Surplus Common Equity Tier 1 of the subsidiary is calculated as Common Equity Tier 1 of the subsidiary less the lower of:
      (1) The minimum Common Equity Tier 1 requirements of the subsidiary;
      (2) The portion of the Common Equity Tier 1 requirement on a consolidated basis attributable to the subsidiary.
   b. The surplus Common Equity Tier 1 attributable to the minority shareholders is calculated by multiplying the surplus Common Equity Tier 1 by the portion of the minority shareholders in Common Equity Tier 1.

Tier 1 capital

3. The amount of the instruments that will be recognized in Additional Tier 1 capital will be calculated as follows:
   a. Surplus Tier 1 capital of a subsidiary is calculated as Tier 1 capital of the subsidiary less the lower of:
      (1) The minimum Tier 1 capital requirements of the subsidiary;

(2) The portion of the Tier 1 capital requirement on a consolidated basis attributable to the subsidiary.

b. The surplus Tier 1 capital attributable to third party investors is calculated by multiplying the surplus Tier 1 capital by the portion of Tier 1 capital held by third party investors out of the banking corporation's Tier 1 capital.

Tier 2 capital

4. The amount of the instruments that will be recognized in Tier 2 capital will be calculated as follows:

a. Surplus total capital of the subsidiary is calculated as total capital of the subsidiary company less the lower of:

(1) The minimum capital requirement for the total capital of the subsidiary;

(2) The portion of the minimum capital requirement for total capital on a consolidated basis attributable to the subsidiary.

b. The surplus total capital attributable to third party investors is calculated by multiplying the surplus total capital by the portion of total capital held by third party investors out of the banking corporation's total capital.

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Appendix C

Criteria for inclusion in Additional Tier 1 capital

The following sets out the minimum set of criteria for an instrument issued by a banking corporation to meet or exceed in order for it to be included in Additional Tier 1 capital:

1. Issued and fully paid-in.
2. Subordinated to depositors, general creditors and subordinated debt of the banking corporation.
3. Is neither secured nor covered by a guarantee of the issuer or related entity or other arrangement that legally or economically enhances the seniority of the claim vis-à-vis the banking corporation’s creditors.
4. Is perpetual, i.e. there is no maturity date and there are no step-ups or other incentives to redeem.
5. May be callable at the initiative of the issuer only after a minimum of five years:
   a. To exercise a call option a banking corporation must receive prior supervisory approval; and
   b. A banking corporation must not do anything which creates an expectation that the call will be exercised; and
   c. Banking corporations must not exercise a call unless:
      i. They replace the called instrument with capital of the same or better quality and the replacement of this capital is done at conditions which are sustainable for the income capacity of the banking corporation[3]; or
      ii. The banking corporation demonstrates that its capital position is well above the minimum capital requirements as stated in Proper Conduct of Banking Business Directive 201 – “Introduction, Scope of

[3] Alternative issues may be made in parallel, but not after the instrument has been redeemed.

Application and Calculation of Requirements" after the call option is exercised.

6. Any repayment of principal (e.g. through repurchase or redemption) must be with prior supervisory approval and banking corporations should not assume or create market expectations that supervisory approval will be given.

7. Dividend/coupon discretion:
   a. The banking corporation must have full discretion at all times to cancel distributions/payments.[4]
   b. Cancellation of discretionary payments must not be an event of default.
   c. Banking corporations must have full access to cancelled payments to meet obligations as they fall due.
   d. Cancellation of distributions/payments must not impose restrictions on the banking corporation except in relation to distributions to common stockholders.

8. Dividends/coupons must be paid out of distributable items.

9. The instrument cannot have a credit sensitive dividend feature, that is a dividend/coupon that is reset periodically based in whole or in part on the banking corporation's credit standing.

10. The instrument cannot contribute to liabilities exceeding assets if such a balance sheet test forms part of national insolvency law.

11. Instruments classified as liabilities for accounting purposes must have a principal loss absorption mechanism, where the banking corporation's Common Equity Tier 1 ratio falls below 7%, through either (i) conversion to common shares, or (ii) a write-down. The write-down will have the following effects:
    a. Reduce the claim of the instrument in liquidation;

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[4] A result of "full discretion at all times to cancel distributions/payments" is that no "dividend pushers" are permitted. An instrument with this feather requires the issuing banking corporation to make a distribution/dividend payment in respect of the instrument if payment in respect of a (generally inferior) capital instrument or other share has been made. Such an obligation is not consistent with the requirement of "full discretion at all times". Furthermore, the term "to cancel distributions/payments" means the absolute cancellation of these payments. Features requiring the banking corporation to may payment/distribution in shares will not be approved.

b. Reduce the amount re-paid when a call is exercised; and

c. Partially or fully reduce coupon/dividend payments on the instrument.

12. Neither the banking corporation nor a related party over which the banking corporation exercises control or significant influence can have purchased the instrument, other than in cases of buy back as per Criteria 6 above, nor can the banking corporation directly or indirectly have funded the purchase of the instrument.

13. The instrument cannot have any features that hinder recapitalization, such as provisions that require the issuer to compensate investors if a new instrument is issued at a lower price during a specified time frame.

14. The instrument is not issued out of a special purpose vehicle (SPV).

15. The instrument has been approved by the Supervisor.

Appendix D

Criteria for inclusion in Tier 2 Capital

In order for capital instruments to be eligible as Tier 2 capital, they must meet the following criteria:

1. Issued and fully paid-in.
2. Subordinated to depositors and general creditors of the banking corporation.
3. Is neither secured nor covered by a guarantee of the issuer or related entity or other arrangement that legally or economically enhances the seniority of the claim vis-à-vis depositors and general creditors of the banking corporation.
4. Maturity:
    a. Minimum original maturity of at least five years.
    b. Recognition in regulatory capital in the remaining five years before maturity will be amortized on a straight line basis.
    c. There are no step-ups or other incentives to redeem.
5. May be callable at the initiative of the issuer only after a minimum of five years:
    a. To exercise a call option, a banking corporation must receive prior supervisory approval.
    b. A banking corporation must not do anything that creates an expectation that the call will be exercised.[5]
    c. A banking corporation must not exercise a call, unless:
        i. It replaces the called instrument with capital of the same or better quality and the replacement of this capital is done at conditions

[5] A call option on an instrument after 5 years but before the beginning of the amortization period shall not be considered as an incentive to redeem as long as the banking corporation does not act to create an expectation that the call will be exercised at that point.

which are sustainable for the income capacity of the banking corporation[6], or

ii. The banking corporation demonstrates that its capital position is well above the minimum capital requirements as stated in Proper Conduct of Banking Business Directive 201 – "Introduction, Scope of Application and Calculation of Requirements" after the call option is exercised.

6. The investor must have no rights to accelerate the repayment of future scheduled payments (coupon or principal), except in liquidation.

7. The instrument cannot have a credit sensitive dividend feather, that is a dividend/coupon that is reset periodically based in whole or in part on the banking corporation's credit standing.

8. Neither the banking corporation nor a related party over which the banking corporation exercises control or significant influence can have purchased the instrument, nor can the bank directly or indirectly have funded the purchase of the instrument.

9. The instrument must have a principal loss absorption mechanism, where the banking corporation's Common Equity Tier 1 ratio falls below 5%, through either (i) conversion to common shares, or (ii) a write-down.

10. The instrument is not issued out of a special purpose vehicle (SPV).

11. Repealed.

[6] Alternative issues may be made in parallel, but not after the instrument has been redeemed.

Appendix E

Loss absorbency requirements at the point of non-viability

In addition to meeting the criteria set out in Appendices C and D, Additional Tier 1 capital and Tier 2 capital instruments included in regulatory capital must meet the following loss absorbency requirements at the point of non-viability:

1. The terms of Tier 1 and Tier 2 capital instruments that are not shares shall include a clause setting out that the instrument will be immediately converted into common shares of the banking corporation or be written off at an objective pre-specified trigger event (as defined in Section 4 below).
2. Any compensation paid to the instrument holders as a result of the write off must be paid immediately in the form of common shares.
3. The banking corporation will at all times maintain the prior authorization necessary to immediately issue the relevant number of shares as detailed in the terms of the instrument at the point of non-viability.
4. The trigger event for non-viability at a banking corporation is the earlier of the following:
    a. Notice by the Supervisor to the banking corporation that the conversion or write-off of the capital instrument is necessary, since without it, in the Banking Supervision Department's opinion, the banking corporation will reach the point of non-viability.
    b. A decision to inject capital from the public sector, or support of equal value, without which the banking corporation will reach the point of non-viability as set forth by the Banking Supervision Department.
5. Issuance of any new shares as a result of a trigger event must occur prior to the injection of capital from the public sector such that the capital received from the public sector will not be diluted.
6. The trigger event for non-viability in capital instruments issued by a subsidiary abroad that are included in the parent company's capital on a consolidated basis is the earlier of the following:

a. Notice by the Supervisor in the parent company's country that the conversion or write-off of the capital instrument is necessary, since without it, in the opinion of the Supervisor in the parent company's country, the subsidiary company will reach the point of non-viability.

b. A decision to inject capital from the public sector, or support of equal value, in the parent company's country, without which the subsidiary company will reach the point of non-viability as set forth by the Supervisor in the parent company's country.

7. Common shares paid out as compensation to instruments holders must be common shares of the issuing banking corporation or of the parent company of the consolidated group.

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Appendix F

Calculating the 15% common equity limit

1. This Appendix is meant to clarify the calculation of the 15% limit on the two items listed in Section 13.

2. Recognition of these items will be limited to 15% of Common Equity Tier 1 capital, after application of all deductions. In order to determine the maximum amount of these items that may be recognized*, banking corporations must multiply the amount of Common Equity Tier 1 capital** (after all deductions, including after the deduction of the two items in full) by 17.65%. This number is derived from the proportion of 15% to 85% (15%/85%=17.65%).

3. For instance, let us assume that a banking corporation has common equity of €85 (calculated after all deductions, including after the deduction of the two items in full).

4. The maximum amount of the two items that can be recognized by the banking corporation in calculating Common Equity Tier 1 capital is €85 x 17.65% = €15. Any excess above €15 will be deducted from Common Equity Tier 1 capital. If the banking corporation has these items (other than amounts deducted after the application of individual 10% limitations) that in aggregate sum up to the 15% limit, the Common Equity Tier 1 capital after including these items will be €85 + €15 = €100. The percentage of the two items to total Common Equity Tier 1 capital is 15%.

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* It is possible that the amount actually recognized will be lower than this maximum amount, or due to the total of both items being below the 15% limit set out in this Appendix, or due to the application of a 10% limit to each item.

** At this stage, this is a "hypothetical" amount of Common Equity Tier 1 capital, which serves only for purposes of determining the deduction of the two items.

Appendix G

Notification format of the issuance of a capital instrument recognized as Tier 2 capital

Date:
Banking Supervision Department
Bank of Israel
Jerusalem

We hereby notify you that on [date]___________, (Bank Name) issued a capital instrument at a total of NIS _________, bearing interest at a rate of ____ percent, and maturing on _________.

This issue meets the requirements of Proper Conduct of Banking Business Directive no. 202 (Capital Adequacy and Measurement—Regulatory Capital), and complies with all the criteria set in Appendices D and E of said Directive.

Attached please find a signed copy of the capital note, as well as a detailed listing of the instrument’s characteristics and a self assessment of compliance with the eligibility criteria.

We hereby authorize the above.

____
CEO/Chief Accountant

____
Legal Counsel

Main characteristics of the Tier 2 capital instrument issued

Fore each of the following items, the banking corporation is to list the relevant information based on the sections included in the capital instrument issuance agreement or other relevant document.

	Characteristic	Relevant information
General		
1	Issuer name	
2	Issue type (private/public)	
3	Indexed/Unindexed	
4	Issue currency	
5	Minimum amount per unit	
Coupon		
6	Fixed/variable interest rate	
7	Interest rate reset after period	
8	Mechanism for resetting interest rate	
Conversion/Write-off mechanism		
9	Is there a conversion or write-off mechanism	
10	If a case of conversion mechanism: what is the conversion ratio	
11	In a case of write-off: Is there an option of a write-up	
12	If there is an option of a write-up—please describe the mechanism.	

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Self assessment regarding compliance with eligibility criteria of a Tier 2 capital instrument that was issued

A banking corporation is required to review and assess every agreement to issue a capital instrument vis-à-vis the requirements for including instruments in regulatory capital listed in Appendices D and E of this Directive. The banking corporation is to fill in all the relevant information on the attached table.

Criteria of including instruments in Tier 2 capital—Appendix D		
Criteria #	**Reference to relevant section in the issuance agreement**	**Notes**
1		
2		
3		
4		
5		
6		
7		
8		
9		
10		
Criteria for loss absorption at the point of non-viability—Appendix E		
Criteria #	**Reference to relevant section in the issuance agreement**	**Notes**
1		
2		
3		
4		
5		
6		
7		

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Revisions

Circular 06 number	Version	Details	Date
2268	1	Original circular	June 20, 2010
2307	2	Update	July 4, 2011
2386	3	Update	May 30, 2013
2555	4	Update	February 26, 2018