

RULES

on Funding Ratios in Foreign Currencies

CHAPTER I General

Article 1

Scope and purpose

These Rules apply to commercial banks and commercial banking consolidations and govern funding ratios in foreign currencies.

These Rules aim to limit maturity mismatches between commercial banks' foreign-denominated assets and liabilities and limit the extent to which commercial banks rely on unstable short-term funding to finance long-term assets denominated in foreign currencies. The Rules are set with reference to Article 12 of the Act on the Central Bank of Iceland, no. 36/2001.

Article 2

Terms and definitions

For the purposes of these Rules, the following terms shall be defined as specified:

1. *Supervised financial entities*: Entities supervised by the Financial Supervisory Authority (FME) according to Article 2 of the Act on Official Supervision of Financial Activities, no. 87/1998; foreign entities subject to comparable supervision in the country of their legal domicile; holding companies in the financial sector, cf. Article 97, Paragraph 4 of the Act on Financial Undertakings, no. 161/2002; and mixed financial holding companies, cf. Article 97, Paragraph 6 of Act no. 161/2002.
2. *Derivative*: A contract whose settlement is based on changes in specific factors in a specified period of time, such as interest, currency exchange rate, securities price, share price index, yield, or commodity price, including but not limited to options, interest rate swaps, currency swaps, and forward contracts.
3. *Funding ratio*: The funding ratio refers to available stable funding, cf. Article 2, Item 12 of these Rules, as a proportion of required stable funding, cf. Article 2, Item 8 of these Rules.
4. *Deposit*: For the purpose of these Rules, a deposit is an amount owed to a creditor by an entity subject to minimum reserve requirements, other than an amount deriving from the issuance of a negotiable debt instrument.
5. *Resident*: An individual or legal entity with a legal address in Iceland.
6. *Small and medium-sized enterprises*: Companies are classified as small or medium-sized enterprises (SME) for the purpose of these Rules if they meet the requirements set forth in Article 17 of the FME Rules on the Capital Requirement and Risk-Weighted Assets of Financial Undertakings, no. 215/2007, and if, in addition, the deposits and other funding from the company and its consolidation are below the reference limits specified in FME Rules no. 215/2007.

7. *Minority investor*: An investor that owns less than 50% of shares in a commercial bank, provided that the investor's shareholding is not considered a qualifying holding according to the Act on Financial Undertakings, no. 161/2002.
8. *Required stable funding*: A commercial bank's required stable funding is determined by classifying the assets of the bank concerned as is set forth in Chapter IV and multiplying the amount of assets in each class by the appropriate weight according to Articles 14-22 of these Rules. The total amount of required stable funding is the sum of the weighted amounts, plus the amount of the commercial bank's off-balance sheet assets multiplied by the appropriate weight according to Article 23 of these Rules.
9. *Public sector entities*: For the purposes of these Rules, public sector entities shall mean non-commercial undertakings and institutions that are wholly owned or controlled by the state or local authorities or comparable authorities in other countries.
10. *Beneficial ownership*: Control or ownership by an entity that enjoys the economic benefits or bears the economic risk of a financial instrument or financial asset, other than the custodian.
11. *Commercial banking consolidation*: A commercial banking consolidation is a parent company that is a commercial bank, together with its subsidiary or subsidiaries; cf. Article 2, Item 7 of the Annual Accounts Act, no. 3/2006.
12. *Available stable funding*: Available stable funding is determined by classifying the capital and liabilities of the credit institution concerned as is set forth in Chapter III and multiplying the book value of capital and liabilities in each class by the appropriate weight according to Articles 6-11. The total amount of available stable funding is the sum of the weighted amounts.
13. *Hypothecated assets*: For the purposes of these Rules, hypothecated assets are assets that are pledged as collateral or otherwise encumbered.
14. *Commercial bank*: A financial undertaking that has been granted a licence to operate as a securities undertaking pursuant to Article 4, Paragraph 1, Item 1 of the Act on Financial Undertakings, no. 161/2002.

CHAPTER II

Funding ratio

Article 3

Funding ratio

The funding ratio shall be specified in Icelandic krónur, in foreign currencies, and as a total. Assets and liabilities shall be classified by residual maturity into the following six periods, as is stated in Articles 6 and 13 of these Rules:

1. Assets and liabilities with a residual maturity of up to three months.
2. Assets and liabilities with a residual maturity of three to six months.
3. Assets and liabilities with a residual maturity of six to nine months.
4. Assets and liabilities with a residual maturity of nine to twelve months.

5. Assets and liabilities with a residual maturity of twelve to thirty-six months.
6. Assets and liabilities with a residual maturity longer than thirty-six months.

The funding ratio as defined in these Rules shall be calculated monthly on the basis of data for the end of each month as presented in a special report submitted to the Central Bank of Iceland; cf. Article 24.

Article 4

Minimum funding ratios

Commercial banks' funding ratio in foreign currencies, calculated with a weight based on a one-year premium according to these Rules, with consideration given to the foreign exchange balance, cf. Paragraph 4 of this Article, shall at all times be no lower than 1.

In addition to the funding ratio according to Paragraph 1, the funding ratio in Icelandic krónur and the total funding ratio shall be calculated. In addition, the funding ratio in foreign currencies based on a three-year premium according to reports, as is further specified in the guidelines provided for in Article 28. The Central Bank considers these ratios in its assessment of risks in commercial banks' funding.

If the Central Bank considers a commercial bank's funding risk or maturity mismatch between assets and liabilities to warrant it, it may increase the requirements made in Paragraph 1 as regards funding ratios by changing the weight of individual items for the calculation of available and/or required funding, or by raising the permissible minimum funding ratio above the level specified in Paragraph 1. The Central Bank shall provide the commercial bank with written grounds for such changes.

Commercial banks shall enter all amounts in millions of Icelandic krónur and specify them in Icelandic krónur and foreign currencies. During calculation, the amounts shall be converted using the central exchange rate of the Icelandic króna according to the last official Central Bank exchange rate listing during the month in question. All amounts are entered without weighting. The calculations shall take account of the foreign exchange balance in accordance with the Central Bank Rules on Foreign Exchange Balance, no. 950/2010. The amount of assets in excess of liabilities in foreign currencies shall be deducted from required stable funding, and the amount of liabilities in excess of assets in foreign currencies shall be deducted from available stable funding.

If a commercial bank should fall below the minimum specified in the Paragraph 1, with consideration also given to Paragraph 3 of this Article, or if it is foreseeable that it will fall below the minimum within the next six months, it shall immediately send the Central Bank a written report outlining the reasons for the deviation. The commercial bank concerned shall also present a dated schedule showing how it intends to achieve the minimum funding ratio provided for in Paragraph 1 of this Article.

CHAPTER III
Available stable funding

Article 5

General

Commercial banks shall enter capital and liabilities in reports on available stable funding, as is further specified in the guidelines to be issued with these Rules, cf. Article 28. Capital and liabilities shall be entered at book value.

Article 6

Residual maturity of capital and liabilities

In classifying capital and liabilities by residual maturity, it shall be assumed that investors and creditors enjoy full rights of acceleration at the first possible opportunity. If the bank has options linked to its funding, it shall assume the first possible maturity date unless it can demonstrate to the Central Bank of Iceland in a well-grounded way that it will not exercise its right to prepayment, exercise its right to lengthen its funding, or in any other way exercise its right to postpone maturity beyond the first possible maturity date.

For long-term liabilities, only those instalments that are due and payable after six months or more shall be classified as funding with a residual maturity of six months or more.

For long-term liabilities, only those instalments that are due and payable after twelve months or more shall be classified as funding with a residual maturity of twelve months or more.

Article 7

Liabilities and capital carrying full weight

Liabilities and capital carrying a weight of 100% as available stable funding are as follows:

1. The capital base according to Article 84 of the Act on Financial Undertakings, no. 161/2002, before the haircut according to Article 85 of the same Act, but net of the part of own funds Part B (Tier 2 capital) with a residual maturity of less than one year.
2. All amounts of other capital items that are not included in Article 7, Item 1 of these Rules and have a residual maturity of one year or longer, apart from items for which it is permissible to reduce the expected residual maturity to less than one year.
3. All amounts of secured and unsecured borrowings and obligations, including term deposits, with a residual maturity of one year or longer. Instalments that are planned within one year on obligations with a residual maturity of more than one year shall be entered to the appropriate period within the year, however, and shall accordingly be assigned reduced weight.

Article 8

Liabilities carrying a 95% weight

Sight deposits and term deposits held by individuals and small and medium-sized enterprises with a time to maturity under one year, which are considered stable according to Article 9, Paragraph 3, Items 1 and 3 of the Central Bank of Iceland Rules on Liquidity Ratio, no. 1031/2014, shall carry a weight of 95% as available stable funding.

Article 9

Liabilities carrying a 90% weight

Sight deposits and term deposits held by individuals and small and medium-sized enterprises that have a time to maturity under one year and fall under Article 9, Paragraph 3, Items 2 and 4 of the Central Bank of Iceland Rules on Liquidity Ratio, no. 1031/2014, shall carry a weight of 90% as available stable funding.

If a commercial bank cannot classify deposits according to the criteria set forth in Article 9, Paragraph 3, Items 1 and 3 of the Central Bank of Iceland Rules on Liquidity Ratio, no. 1031/2014, all deposits held by individuals and small and medium-sized enterprises shall carry a weight of 90%. Commercial banks shall send the Central Bank annual reports detailing the definitions and premises for the classification of deposits between Articles 8 and 9, and shall submit such reports each time changes are made to these definitions and premises.

Article 10

Liabilities carrying a 50% weight

Liabilities and capital carrying a weight of 50% as available stable funding are as follows:

1. Secured and unsecured funding with a residual maturity of less than one year, from sources other than supervised financial entities.
2. Deposits that have been approved by the Central Bank of Iceland as deposits of legal entities in a business relationship with the commercial bank according to Article 9, Paragraph 3, Item 5 of the Central Bank of Iceland Rules on Liquidity Ratio, no. 1031/2014.
3. Funding from the state, municipalities, public sector entities, and international development banks, with a residual maturity of less than one year.
4. Income tax liabilities or other deferred taxes and minority interests with a potential residual maturity of six months to one year.
5. Other secured and unsecured funding that falls neither under Items 1-4 nor under Articles 7-9 of these Rules and has a residual maturity of six months to one year, including funding from central banks and supervised financial entities.

Article 11

Liabilities carrying a weight of 0%

Liabilities and capital carrying a weight of 0% as available stable funding are as follows:

1. All other classes of capital and liabilities that do not fall under Articles 7-10 of these Rules, including other funding with a residual maturity of less than six months from central banks or supervised financial entities.
2. Other liabilities without a specified maturity date, including short positions and callable liabilities, but not including income tax liabilities or other deferred taxes and minority interests with a potential residual maturity of more than six months.
3. Net derivative liabilities, if derivative liabilities exceed derivative assets.

CHAPTER IV
Required stable funding

Article 12
General

Commercial banks shall enter asset items in reports as is further specified in the guidelines issued by the Central Bank according to Article 28 of these Rules.

Assets shall be entered at book value and be assigned appropriate weights based on their residual maturity and liquidity value.

Article 13
Residual maturity of assets

When the residual maturity of assets is determined, it shall be assumed that debtors will exercise in full their right to defer payment dates and extend the residual maturity of the commercial bank's assets.

Commercial banks are authorised to enter the portion of loans payable within three years to the appropriate time periods within the three-year period.

Article 14
Weights of assets that are hypothecated or encumbered

Assets on the balance sheet that are hypothecated for a period of one year or longer shall be assigned a weight of 100% for required stable funding.

Assets hypothecated for a period of six months or more, but less than one year, which would have been assigned a weight less than 50% for required stable funding if they had not been hypothecated shall be assigned a weight of 50% for required stable funding.

Assets hypothecated for a period of six months or more, but less than one year, which would have been assigned a weight more than 50% for required stable funding if they had not been hypothecated shall retain the weight they would have carried if they had not been hypothecated.

Assets hypothecated for a period of less than six months shall be assigned the weight for required stable funding that is assigned to comparable unencumbered assets.

Article 15
Securities transactions and beneficial ownership

In calculating required stable funding, commercial banks shall exclude securities borrowed in securities transactions, such as reverse repo transactions or swap agreements, if they are not the beneficial owners of such securities. Commercial banks shall also exclude those securities that they have received through swap agreements if they do not appear on their balance sheets.

In calculating required stable funding, commercial banks shall include securities that they have loaned out or have hypothecated in securities transactions when they are the beneficial owners of such securities. The commercial banks shall assign them appropriate weights in accordance with Articles 16-23 of these Rules.

Article 16

Assets with a weight of 0% for required stable funding

The following assets shall be assigned a weight of 0% for required stable funding:

1. Cash.
2. All central bank deposits
3. All unsecured loans to supervised banks and savings banks, cf. Article 2, Paragraph 1, Item 1 of the Act on Official Supervision of Financial Activities, no. 87/1998, with a residual maturity of less than six months.

Article 17

Assets with a weight of 5% for required stable funding

Unencumbered liquid assets classified under level 1 according to Article 6, Paragraph 2 of the Central Bank of Iceland Rules on Liquidity Ratio, etc., no. 1031/2014, which do not fall under Article 16 of these Rules, shall be assigned a weight of 5% for required stable funding.

Article 18

Assets with a weight of 15% for required stable funding

Unencumbered liquid assets classified under level 2A according to Article 6, Paragraph 3 of the Central Bank of Iceland Rules on Liquidity Ratio, etc., no. 1031/2014, shall be assigned a weight of 15% for required stable funding.

Article 19

Assets with a weight of 50% for required stable funding

The following assets shall be assigned a weight of 50% for required stable funding:

1. Unencumbered liquid assets classified under level 2B which have been assigned a weight of 50% or more according to Article 6, Paragraph 4 of the Central Bank of Iceland Rules on Liquidity Ratio, etc., no. 1031/2014.
2. Liquid assets that have been assigned a weight of 50% or more according to Article 6 of the Central Bank of Iceland Rules on Liquidity Ratio, etc., no. 1031/2014, and are hypothecated for more than six months but less than one year.
3. All loans to supervised banks and savings banks, cf. Article 2, Paragraph 1, Item 1 of the Act on Official Supervision of Financial Activities, no. 87/1998, with a residual maturity of more than six months but less than one year.
4. Deposits that are held with other financial institutions with which the commercial bank has a business relationship for its operational functions and that have been approved as operational deposits according to Article 9, Paragraph 3, Item 5 of the Central Bank of Iceland Rules on Liquidity Ratio, etc., no. 1031/2014, and Article 18 of the same Rules.
5. All other assets not classified as liquid assets according to Article 6 of the Central Bank of Iceland Rules on Liquidity Ratio, etc., no. 1031/2014, which have a residual maturity of less than one year, including loans to businesses, retail loans to individuals, loans to sovereign nations, municipalities, international development banks, central banks, and public sector entities.

Article 20

Assets with a weight of 65% for required stable funding

The following assets shall be assigned a weight of 65% for required stable funding:

1. Unencumbered residential mortgages that have a residual maturity of one year or more and would qualify for a risk weight of 35% or lower according to the standard approach provided for in Chapter V of the Financial Supervisory Authority Rules on the Capital Requirement and Risk-Weighted Assets of Financial Undertakings, no. 215/2007.
2. Other unencumbered loans not falling under Articles 16-19 of these Rules, excluding loans to financial institutions, that have a residual maturity of one year or more and would qualify for a risk weight of 35% or lower according to the standard approach provided for in Chapter V of the Financial Supervisory Authority Rules on the Capital Requirement and Risk-Weighted Assets of Financial Undertakings, no. 215/2007.

Article 21

Assets with a weight of 85% for required stable funding

The following assets shall be assigned a weight of 85% for required stable funding:

1. Other unencumbered performing loans, excluding loans to financial institutions, that have a residual maturity of one year or more and carry a risk weight higher than 35% according to the standard approach provided for in Chapter V of the Financial Supervisory Authority Rules on the Capital Requirement and Risk-Weighted Assets of Financial Undertakings, no. 215/2007.
2. Unencumbered securities that are not in default but are not considered liquid assets according to Article 6 of the Central Bank of Iceland Rules on Liquidity Ratio, etc., no. 1031/2014, including exchange-traded equity securities.
3. Physical traded commodities, including gold.

Article 22

Assets with a weight of 100% for required stable funding

The following assets shall be assigned a weight of 100% for required stable funding:

1. All assets that are hypothecated for a period of one year or longer.
2. Net derivative assets if derivative assets exceed derivative liabilities.
3. All other assets not falling under the provisions of Articles 16-21, including loans and securities in default, loans to financial institutions with a residual maturity of one year or more, unlisted equity securities, real estate, pension assets, intangible assets, tax liabilities, and insurance assets.

Article 23

Off-balance sheet assets

The following off-balance sheet assets shall be assigned a weight of 5% for required stable funding:

1. The portion of irrevocable credit and liquidity facilities that is unutilised or undrawn.
2. The portion of conditionally revocable credit and liquidity facilities that is unutilised or undrawn

The following assets carry a weight of 0%:

1. Credit and liquidity facilities that the commercial bank may revoke unconditionally.
2. Obligations due to underwriting and other services to legal entities in connection with trade in goods and services, including guarantees.
3. Guarantees other than those listed in Item 2.
4. Non-contractual obligations, such as:
 - a. Potential requests for repurchases of the bank's own debt obligations or related conduits, securities investment vehicles, and other such financing facilities.
 - b. Financial instruments where customers anticipate ready marketability, such as adjustable-rate notes and variable-rate demand notes (VRDN).
 - c. Managed funds that are marketed with the objective of maintaining a stable value.
5. All other off-balance sheet obligations not listed in Paragraph 1 or in Items 1-4.

CHAPTER V

Reporting, information, penalties, guidelines, and entry into force

Article 24

Reporting

Reports on available stable funding and required stable funding for the calculation of the funding ratio provided for in Article 2, Item 3 of these Rules shall be submitted to the Central Bank no later than on the tenth day of each month for the parent company and no later than the twentieth day of each month for commercial banking consolidations. If the due date falls on a weekend or a holiday, the report shall be submitted on the business day immediately following.

The commercial bank's internal auditor shall review the methods for reporting stable funding at least once a year and submit to the Central Bank a written statement concerning the review.

Article 25

Information

It is required to provide the Central Bank with all information and data the Bank considers necessary to comply with these Rules; failure to do so shall be subject to penalties; cf. Article 26 of these Rules.

Article 26

Per diem fines

If a commercial bank's funding ratio falls short of the minimum set forth in Article 4, Paragraph 1 of these Rules, per diem fines shall be calculated on the shortfall, according to the Rules on the Imposition of Periodic Penalty Payments, currently no. 389/2002.

The Central Bank may impose per diem fines for negligence in reporting in accordance with Article 24 of these Rules, on the basis of the Rules on the Imposition of Periodic Penalty Payments, currently no. 389/2002.

If a commercial bank neglects to provide the Central Bank with information and data that the Bank deems necessary in order to enforce these Rules, cf. Article 25, the Bank is authorised

to impose per diem fines in accordance with the Rules on the Imposition of Periodic Penalty Payments, currently no. 389/2002.

The determination of per diem fines, the right of appeal, and collection of fines are subject to the provisions of Articles 6, 7, and 8 of the Rules on the Imposition of Periodic Penalty Payments, currently no. 389/2002, shall apply, as appropriate, and the direct debit of per diem fines shall be subject to Article 26, Paragraph 5, as applicable.

The Central Bank may debit calculated penalties from the current account that the respective commercial bank holds with the Bank at least seven days after it has been notified of the penalties.

Article 27

Temporary authorisation concerning commercial banking consolidations

The Central Bank may grant a commercial bank a temporary authorisation to exclude one or more specified subsidiaries from its consolidated reporting, provided that the parent company of the commercial banking consolidation demonstrates to the Bank's satisfaction that the subsidiary(-ies) in question have little effect on the consolidation's funding ratio and liquidity risk and/or the maturity mismatch between its assets and liabilities. The parent company shall submit a written application supported by well-grounded reasons why the subsidiary(-ies) in question should be excluded from consolidated reporting.

Article 28

Guidelines

The Central Bank issues guidelines concerning further implementation of these Rules.

Article 29

Entry into force, etc.

These Rules are set in accordance with the authority contained in Article 12, Paragraph 2 of the Act on the Central Bank of Iceland, no. 36/2001, cf. Articles 29 and 37 of the same Act, and shall enter into force on 1 December 2014.

Temporary Provisions

I.

For the purpose of adaptation to these Rules, the minimum funding ratios for commercial banks, cf. Article 4, Paragraph 1 of these Rules; cf. also Article 3, Paragraph 2, Item 1 of these Rules, shall be as follows until 1 January 2017:

1. From the entry into force of these Rules through 31 December 2015, commercial banks' funding ratio in foreign currency shall be at least 0.8.
2. From 1 January 2016 through 31 December 2016, commercial banks' funding ratio in foreign currency shall be at least 0.9.
3. From 1 January 2017 onwards, commercial banks' funding ratio in foreign currency shall be at least 1.

This Temporary Provision expires on 1 January 2017, from which date commercial banks' minimum liquidity ratio shall be in accordance with Article 4, Paragraph 1 of these Rules; cf. Paragraph 1, Item 5 of this Temporary Provision.

Reykjavík, 26 November 2014

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