

Executive Order on Large Exposures¹

Executive Order no. 1232 of 31 October 2010

The following shall be laid down pursuant to section 71(2), section 148, nos. 1-4 and 6, section 175a(2) and section 373(4) of the Financial Business Act, cf. Consolidated Act no. 1125 of 23 September 2010:

Scope and definitions

1.-(1) This Executive Order shall apply to:

- 1) Banks.
- 2) Mortgage-credit institutions.
- 3) Investment companies.
- 4) Investment management companies.
- 5) Branches in Denmark of banks, mortgage-credit institutions, investment companies and investment management companies, licensed in a country outside the European Union with which the Community has not entered into an agreement for financial area (third countries).
- 6) Groups where the parent undertaking is one of the undertakings or a financial holding company mentioned in nos. 1-4, cf. section 5(1), nos. 10-14 of the Financial Business Act, and where, pursuant to section 171(2), section 172(2), section 173(2) or section 174(2) of the Financial Business Act, a consolidated calculation shall be made.
- 7) Subgroups, where one of the undertakings or a financial holding company mentioned in nos. 1-4, cf. section 5(1), nos. 10-14 of the Financial Business Act, is a parent undertaking, and where pursuant to section 171(2), section 172(2), section 173(2) or section 174(2) of the Financial Business Act, a consolidated calculation shall be made.
- 8) Groups where the parent undertaking is a financial holding company other than an investment holding company, investment management holding company, bank holding company, or mortgage-credit holding company, or a financial holding company covered by section 177(1) of the Financial Business Act.

(2) In the following, the term "undertaking" shall be a common designation for all the entities mentioned in subsection (1), for which this Executive Order shall apply.

(3) Groups covered by subsection 1, no. 8, where section 145 of the Financial Business Act is not applicable, shall solely be covered by the provisions of section 4, section 11(6) and section 12 of this Executive Order.

¹ This Executive Order includes provisions implementing parts of Directive 2002/87/EC of the European Parliament and of the Council (Official Journal 2002, no. L 35/1) (Financial Conglomerates Directive), parts of Directive 2006/48/EC of the European Parliament and of the Council (Official Journal 2006, no. L 177/1), (Credit Institutions Directive), parts of Directive 2006/49/EC of the European Parliament and of the Council (Official Journal 2006, no. L 177/201), (Capital Requirements Directive), Commission Directive 2007/18/EC of 27 March 2007 amending Directive 2006/48/EC of the European Parliament and of the Council as regards the exclusion or inclusion of certain institutions from its scope of application and the treatment of exposures to multilateral development banks (Text with EEA relevance) and parts of Directive 2009/111/EC of the European Parliament and of the Council (Official Journal 2009, no. L302/97), (CRDII) amending Directive 2006/48/EC, Directive 2006/49/EC and Directive 2007/64/EC as regards banks affiliated to central institutions, certain own funds items, large exposures, supervisory arrangements, and crisis management (Text with EEA relevance).

2. For the purposes of this Executive Order:

1) *Exposure:*

Shall be defined as in section 5(1), no. 16 of the Financial Business Act, i.e. the sum of all the positions that involve a credit risk for the undertaking and equity holdings, except for the following positions:

- a) For foreign exchange transactions: Positions, which have been incurred in the ordinary course of settlement of a transaction during the 48 hours following payment.
- b) For purchases or sales of securities: Positions, which have been incurred in the ordinary course of settlement of a transaction during the five business days following payment or delivery of the securities, whichever is the earlier.
- c) For money transmission services, including execution of payment orders, clearing and settlement of securities in any currency and correspondent bank or offers regarding clearing, settlement and deposit of financial instruments for clients: Positions, in respect of delayed receipt of financing and other positions, incurred as a consequence of client activity and which do not extend for longer than the following business day.
- d) For money transmission services, including execution of payment orders, clearing and settlement of securities in any currency and correspondent bank: Intra-day positions with institutions which offer these services.

2) *Credit risk:*

The risk of incurring a financial loss as a consequence of counterparties' breach of payment obligations.

3) *Client:*

Any natural or legal person with which the undertaking has an exposure.

4) *Trading book:*

As defined in sections 6 and 7 of the Executive Order on Capital Adequacy.

5) *Securities financing instruments:*

Repurchase transactions, margin loans and transactions concerning securities and commodities lending and borrowing, as defined in section 4 of the Executive Order on Capital Adequacy.

6) *Forward transactions:*

As defined in section 4 of the Executive Order on Capital Adequacy.

7) *Covered bonds:*

Covered bonds, mortgage-credit bonds issued no later than 31 December 2007, bearer bonds issued by Danmarks Skibskredit no later than 31 December 2007, and other covered bonds, cf. Annex VI, Part 1, paragraph 68 of Directive 2006/48/EC, as defined in Annex 3 to the Executive Order on Capital Adequacy.

8) *Collective investment schemes:*

Schemes covered by section 1 of the Investment Associations and Special-Purpose Associations as well as other Collective Investment Schemes etc. Act.

9) *Securitisation positions:*

Exposures against securitisations as defined in Annex 11 to the Executive Order on Capital Adequacy.

10) *Pooled schemes:*

Schemes covered by the Executive Order on Pooled Schemes and Other Tax-Privileged Savings, etc., cf. section 50 of the Financial Business Act.

Calculation of an exposure

3.-(1) The total exposure with a single client shall be calculated by adding direct exposures incurred with the client, to indirect exposures with the client in the form of underlying exposures in units in collective investment schemes and in the form of underlying exposures in securitisation positions. The total exposure with a group of mutually connected clients shall be calculated by adding the exposures of the undertaking with the clients which are part of the group of mutually connected clients.

(2) A group of mutually connected clients shall be limited and identified in accordance with Annex 1.

(3) Calculation of indirect exposures through underlying exposures in units in collective investment schemes and securitisation positions shall be made in accordance with Annex 2.

4.-(1) The individual parts of the exposure shall be calculated in accordance with regulations in the Executive Order on financial reports for credit institutions and investment companies, etc., unless otherwise stipulated in this Executive Order, cf. however, section 145(9) and (10) of the Financial Business Act.

(2) Off-balance-sheet items, cf. Annex 4 to the Executive Order on Capital Adequacy, shall be included in the calculation of exposures at the nominal value after provisions.

(3) Securities and financial instruments included in pooled schemes, where the entire positive or negative return of the pool accrues to or is covered by the clients, shall not be included in the calculation of exposures.

(4) Derivative financial instruments covered by Annex 17 to the Executive Order on Capital Adequacy and forward transactions shall be calculated in the exposure with the counterparty in accordance with the rules on calculating counterparty risk in Part 6 of the Executive Order on Capital Adequacy.

(5) Securities financing instruments shall be included in the calculation of exposures as loans. If the undertaking has a licence to use the internal model method for counterparty risk (EPE models) pursuant to section 49 of the Executive Order on Capital Adequacy, the undertaking may instead use this model in the calculation of exposures deriving from securities financing instruments.

(6) If a purchase or sale of securities or commodities, including spot transactions, forward transactions and other transactions with physical delivery has not been settled at the beginning of the sixth business day at the latest, after the agreed settlement day, the market value of the relevant securities at the calculation date minus the agreed settlement price shall be included in the exposure with the counterparty, if there is a positive difference. Upon sale of securities, the exposure shall be calculated as the agreed settlement price minus the market price of the relevant securities at the calculation date, if there is a positive difference.

(7) If the undertaking has paid for securities or commodities before delivery, or has delivered securities or currency in the trading book before receipt of payment, the instalments due shall be included in the exposure with the counterparty from the beginning of the sixth business day after the first agreed settlement date until the date when the outstanding amount, the securities or commodities are either paid, delivered or written off.

(8) For foreign exchange transactions, subsections (6) and (7) shall apply correspondingly, including however, the exposure from the beginning of the third business day.

(9) Securities shall be included in the calculation of the exposure with the issuer of the security from the time of the completion of the transaction.

(10) If the undertaking uses Annex 12 or Annex 15 to the Executive Order on Capital Adequacy when calculating the risk-weighted items for the trading book, the undertaking shall for securities in the trading book include the difference, if positive, between long and short positions in all securities issued by the same issuer, where the position in each of the different securities shall be calculated in accordance with the methods in Annex 12 to the Executive Order on Capital Adequacy.

(11) If the undertaking does not use Annex 12 or Annex 15 to the Executive Order on Capital Adequacy when calculating the risk-weighted items for the trading book, the undertaking shall include securities in the trading book of the exposure with the issuer according to the same method as when calculating non-trading-book securities.

(12) For issue underwritings, the guarantee is included in the exposure with the issuer of the security after deduction of positions in the flotation, which are subscribed to or sub-underwritten by third parties on the basis of formal agreements.

Deduction for particularly secure parts

5.-(1) The undertaking may, when calculating the exposure limits in section 145(1) and (2) of the Financial Business Act, disregard the following:

- 1) Exposures with central governments, central banks or public entities, which have zero-weighting status according to the standard method for credit risk, cf. Annex 3 to the Executive Order on Capital Adequacy.
- 2) Exposures with international organisations or multilateral development banks which have zero-weighting status according to the standard method for credit risk, cf. Annex 3 to the Executive Order on Capital Adequacy.
- 3) Exposures with Danish municipalities and regions, the Greenland Self-Government, the Government of the Faeroe Islands and municipalities in Greenland and on the Faeroe Islands, as well as regional governments and local authorities in the European Economic Area (the EEA), which have zero-weighting status according to the standard method for credit risk, cf. Annex 3 to the Executive Order on Capital Adequacy.
- 4) Exposures covered by requirements of the licence pursuant to section 182(1) of the Financial Business Act.
- 5) Exposures secured by collateral in the form of deposits in the lending undertaking or in a credit institution which is the parent company or subsidiary of the lender.
- 6) Exposures of investment companies and investment association management companies secured by collateral in the form of margin deposits.
- 7) Exposures secured by collateral in the form of certificates of deposit issued by the lending undertaking or a credit institution which is the parent company or subsidiary of the lender, and deposited with one of these undertakings.
- 8) Exposures incurred as a consequence of undrawn credit facilities classified as off-balance-sheet items with low risk pursuant to Annex 4 to the Executive Order on

Capital Adequacy, and where an agreement has been made with the client in accordance to which the facility may only be drawn if it has been confirmed that it will not result in breach of the limits set in section 145(1), or where relevant, section 145(2) of the Financial Business Act.

- 9) Covered bonds within 90 percent of the officially listed share price.
- 10) 80 percent of the value of exposures with regional governments or local authorities in the European Economic Area (EEA), which according to the capital adequacy rules of the home country receive a 20 per cent risk-weight according to the standard method for credit risk, cf. Annex 3 to the Executive Order on Capital Adequacy.
- 11) Non-subordinated exposures with credit institutions located in the European Economic Area (EEA), provided that such exposures do not have longer duration than the subsequent trading day and that they are agreed in DKK, NOK, SEK or ISK.
- 12) 50 percent of exposures consisting of guarantees to Danmarks Nationalbank or a clearing centre in connection with settlement of payments in the settlement of securities transactions.
- 13) 50 percent of issue underwritings with an original maturity of less than one year.
- 14) 50 percent of guarantees for the capital base of VP Securities A/S (VP).
- 15) Statutory registration guarantees received by mortgage-credit institutions up until final entry in the Land Register, and which have not been included in the solvency statement.

Deduction for collateral, guarantees etc. received

6.-(1) The effect of collateral, guarantees, etc. received may be calculated pursuant to sections 7-8 below, if the undertaking complies with the minimum requirements and conditions for including the relevant collateral, guarantees, etc., laid down in Annex 7 to the Executive Order on Capital Adequacy, cf. however subsection (2).

(2) If the undertaking uses the method in section 8(3), the undertaking shall comply with the relevant requirements in Annex 8 to the Executive Order on Capital Adequacy concerning own estimates of loss given default (LGD) in the calculation of the effect of financial collateral.

(3) If the undertaking has issued a credit-linked note complying with the conditions in Annex 7, points 29-34 to the Executive Order on Capital Adequacy, credit protection may be included as cash collateral in accordance with the methods in section 8(1) and (3) of this Executive Order.

(4) If the undertaking has entered into a netting agreement concerning on-balance-sheet claims complying with the provisions in Annex 7, point 107 to the Executive Order on Capital Adequacy, credit protection may be included as cash collateral in accordance with the methods in section 8(1) and (3) of this Executive Order.

(5) The designation "guarantee" as used in sections 7 and 8 below shall also include credit derivatives complying with the requirements to be included as credit protection in the calculation of risk-weighted items pursuant to Annex 7, points 28-34 to the Executive Order on Capital Adequacy, except credit-linked notes.

7.-(1) If an exposure is guaranteed by a third party or secured by financial collateral issued by a third party, the undertaking may, in the calculation of exposure limits in section 145(1) and (2) of the Financial Business Act,

- 1) treat the part of the exposure guaranteed as having been incurred to the guarantor rather than to the client, provided however that the unsecured exposure with the guarantor would be assigned a risk weight similar to or lower than the risk weight of

the unsecured exposure with the client according to the standard method for credit risk laid down in Annex 3 to the Executive Order on Capital Adequacy, and

- 2) treat the part of the exposure covered by the market value of the collateral as having been incurred to the collateral issuer rather than to the client, provided however that the part of the exposure covered by the collateral would be assigned a risk weight similar to or lower than the risk weight of the unsecured exposure with the client according to the standard method for credit risk laid down in Annex 3 to the Executive Order on Capital Adequacy.

(2) If the undertaking uses the method in subsection (1), no. 1 for guarantees, the undertaking shall

- 1) adjust the value of the exposure deemed to be covered in accordance with the method in Annex 7, point 18 to the Executive Order on Capital Adequacy, if the guarantee is denominated in a currency different from that in which the exposure is denominated,
- 2) adjust the value of the exposure deemed to be covered by the guarantee in accordance with the method in Annex 7, points 21-28 to the Executive Order on Capital Adequacy, if the maturity of the guarantee is shorter than the maturity of the exposure, and
- 3) treat the part of the exposure not covered by the guarantee as an exposure with the client.

(3) If the undertaking uses Annex 12 and Annex 15 to the Executive Order on Capital Adequacy in its solvency statement, the undertaking may not use the method in subsection (1), no. 2, for the part of the exposure that pertains to items in the trading book.

(4) If the maturity of the collateral is shorter than the maturity of the exposure, the undertaking may not use the method in subsection (1), no. 2.

8.-(1) If the conditions in subsections (5)-(7) have been met, the undertaking may, in the calculation of exposure limits in section 145(1) and (2) of the Financial Business Act, use the fully adjusted size of the exposure according to the comprehensive method for financial collateral, cf. Annex 7, points 58-96 and point 107 to the Executive Order on Capital Adequacy, and the method for calculation of the size of the exposure for securities financing instruments etc. in connection with netting, cf. Annex 10 to the Executive Order on Capital Adequacy.

(2) If the undertaking uses the fully adjusted size of the exposure pursuant to subsection (1), the undertaking may not at the same time use the method in section 7(1), no. 2 for other exposures, unless the undertaking similarly uses both the extended method for financial collateral and the simple method for financial collateral in the solvency statement.

(3) If, in the solvency statement, the undertaking uses own estimates for losses given default (LGD) for an exposure category, cf. sections 19-33 of the Executive Order on Capital Adequacy, the undertaking may submit an application to the Danish FSA for a licence to use own estimates of the effect of financial collateral in the calculation of non-trading-book exposures in relation to the limits set in section 145(1) and (2) of the Financial Business Act. A licence shall presuppose

- 1) that, in calculation of the size of the exposure, the method of calculation of the effect of financial collateral is consistent with the method that the undertaking uses in estimating LGD in its solvency statement,
- 2) that the undertaking's estimate of the effect of financial collateral on its exposures can be kept separate from other aspects of significance for losses given default (LGD),
- 3) that the undertaking's estimates of the effect of financial collateral are appropriate to use for reducing exposures for the purpose of meeting the exposure limits in section 145(1) and (2) of the Financial Business Act, and
- 4) that the conditions in subsections (5)-(7) are met.

(4) If the undertaking is using the method in subsection (3), the undertaking may not at the same time use the methods in subsection (1) or section 7(1), no. 2 for other exposures.

(5) An undertaking which is using the methods in subsection (1) or (3) shall regularly carry out stress tests of credit-risk concentrations, including in relation to the sales price of collateral included in the calculation of the reduction in the exposure. The stress tests shall include risks due to potential changes in market terms which might negatively affect both the adequate capital base, cf. section 124(1) and section 125(1) of the Financial Business Act, and the possibilities of realising collateral in stressed situations. The undertaking shall document that the stress tests carried out are adequate and appropriate to assess such risks.

(6) If the stress tests pursuant to subsection (5) indicate a lower realisation value of collateral in stressed situations than the value which as a minimum might be included in calculation of the exposure pursuant to subsections (1) and (3), the value of the collateral shall be reduced correspondingly in the calculation of the size of the exposure in relation to the limits in section 145(1) and (2) of the Financial Business Act.

(7) An undertaking using the method in subsections (1) or (3) shall have the following procedures to manage concentrations of risk:

- 1) procedures for managing risks occurring due to lack of concordance between the maturity of the exposure and the maturity of the asset provided as collateral.
- 2) procedures for addressing situations where the stress tests indicate a lower realisation value of collateral in stressed situations than the realisation value included pursuant to the method in subsection (1) or, if relevant, subsection (3).
- 3) procedures for managing risks of concentration following from use of methods to reduce credit risk, including large indirect credit exposures to an issuer of securities provided as collateral.

9.-(1) The undertaking may reduce the exposure by up to 50 percent of the value of residential property if at least one of the conditions below are met, cf. however subsection (2):

- 1) the exposure is secured by collateral in residential property which is or will be occupied or let by the owner, including recreational properties and farmsteads on agricultural properties, or by shares in Finnish residential housing companies, operating in accordance with the Finnish Housing Act of 1991 or subsequent equivalent legislation.
- 2) the exposure relates to a leasing transaction under which the lessor retains full ownership of the residential property leased for as long as the lessee has not exercised his option to purchase.

(2) The conditions in Annex 3, point 16 to the Executive Order on Capital Adequacy shall be met in order for collateral in residential properties to reduce the value of an exposure pursuant to subsection (1).

Exceeding exposure limits for exposures in the trading book

10.-(1) An application pursuant to section 145(7) of the Financial Business Act for a licence permitting exposures in the trading book to exceed the exposure limits in section 145(1) and (2) of the Financial Business Act, shall include an explanation of the undertaking's need for the possibility to exceed exposure limits and provide information on instruments in the trading book which might give rise to exceeding the limits, and indicate which clients or groups of mutually connected clients are to be covered by the possibility of exceeding.

(2) A licence from the Danish FSA pursuant to section 145(7) of the Financial Business Act may as a maximum be obtained for a period of one year, after which exceeding exposure limits will require a renewed licence.

(3) If the undertaking has a licence from the Danish FSA pursuant to subsection (2), the undertaking shall fulfil the following:

- 1) exposure of the undertaking with the non-trading-book client or group of mutually connected non-trading-book clients shall be within the limits of section 145(1) and (2) of the Financial Business Act so that the excess solely derives from the trading book.
- 2) the undertaking shall fulfil a requirement of additional capital to cover the excess, calculated according to the method set out in Annex 3 to this Executive Order.
- 3) if the excess has lasted for 10 days or less, the exposure of the undertaking in the trading book with the client or group of mutually connected clients may, as a maximum, represent 500 percent of the undertaking's capital base.
- 4) the sum of the excesses of exposure limits in the trading book, which have a duration of more than 10 days, may as a maximum represent 600 percent of the capital base of the undertaking.
- 5) the undertaking shall, in connection with the reports to the Danish FSA pursuant to section 11 below, submit information about all circumstances where the exposure limits in section 145(1) and (2) of the Financial Business Act have been overshoot within the past three months, including information about the scope of the excess and the identity of the client.

(4) The undertaking shall, without undue delay, submit a report to the Danish FSA on reductions in exposures in the trading book where the excess was of more than ten days' duration and where the reduction is based on temporary disposal of the exposure to another legal entity, or where the reduction is based on closing transactions by means of opposite positions that create other exposures. The report shall document that the reduction was not intended to circumvent the higher capital requirement for excess of more than ten days' duration pursuant to Annex 3, point 4, cf. subsection (1), no. 2.

Reporting

11.-(1) The undertaking shall report exposures covered by section 145(4) and (5) of the Financial Business Act to the Danish FSA as at the end of each quarter. The reports shall be received by the Danish FSA no later than 20 business days after the end of the quarter. However, reports for the end of the year shall be received by the Danish FSA no later than 30 business days after the end of the year.

(2) Exposures with undertakings which are fully included in the consolidation and which, pursuant to section 145(8) of the Financial Business Act, are exempt from the exposure limits in section 145(1) and (2) of the Financial Business Act, shall in connection with the report pursuant to subsection (1) be reported as exposures with full deduction of particularly secure parts.

(3) The reports shall be made on a machine-readable or electronic medium.

(4) The reports shall be approved by the board of management of the undertaking.

(5) If the undertaking is a parent undertaking, the undertaking shall also report exposures which at group level are covered by the duty to report pursuant to section 145(4) and (5) of the Financial Business Act.

(6) If the undertaking is a financial holding company, which is not an investment holding company, a bank holding company or a mortgage-credit institution, or a financial holding company covered by section 177(1) of the Financial Business Act, and where section 145 of the Financial Business Act does not apply, cf. section 1(3), the undertaking shall, no later than 30 days after the end of the year, report exposures which as at the end of the year at group level are covered by the duty to report pursuant to section 175a of the Financial Business Act. Exposures reported pursuant to this subsection shall be calculated before deduction for particularly secure parts and collateral received and without taking into account the provisions in section 3 of this Executive Order on mutually connected clients or adding any indirect exposures with the client in the form of underlying exposures in units in collective investment schemes or securitisation positions. The calculation shall, however, include the parts of the exposure comprising repurchase transactions, loans or deposits in securities or commodities, after deduction for collateral, guarantees etc. received pursuant to the provisions hereon in sections 6-8 of this Executive Order.

Penalties, entry into force and transitional provisions

12.-(1) Violation of sections 3 and 4, section 6(1)-(3), section 7(2)-(4), section 8(2) and (4)-(7), section 9, section 10(3) and (4) and section 11, shall be subject to a fine.

(2) Companies etc. (legal persons) may incur criminal liability under the rules of Part 5 of the Criminal Code.

13.-(1) This Executive Order shall enter into force on 31 December 2010.

(2) At the same time Executive Order no. 1472 of 13 December 2006 on large exposures and Executive Order no. 793 of 10 July 2004 on reporting of large exposures for groups where the parent undertaking is a financial holding company or a financial undertaking, and where a full consolidated calculation are not to be made, shall be repealed.

(3) Undertakings may, until 31 December 2012, upon calculation of exposure limits pursuant to section 145(1) of the Financial Business Act, disregard 80 percent of exposures incurred before 31 December 2009 with credit institutions, investment companies, investment management companies, stock exchanges, authorised market places and clearing centres, situated in countries with zero-weighting status pursuant to the standard method for credit risk, cf. Annex 3 to the Executive Order on Capital Adequacy.

(4) Undertakings may, until 31 December 2015, treat schemes with underlying exposures acquired before 31 January 2010 in accordance with the rules on large exposures applicable on 30 December 2010 instead of using the rules in Annex 2.

Danish Financial Supervisory Authority, 31 October 2010

Ulrik Nødgaard

/ Kristian Vie Madsen

Mutually connected clients

Scope

- 1) This Annex includes provisions on mutually connected clients, cf. section 3(2).

Definition

- 2) Group of mutually connect clients shall mean:
 - a) two or more natural or legal persons who constitute a single risk because one of them, directly or indirectly, has control over the other or others, cf. point 3, or
 - b) two or more natural or legal persons between whom there is no relationship of control but who are so mutually connected that, if one of them were to experience financial problems, the other or all of the others would be likely to encounter financial problems.

Direct or indirect control (re point 2, a))

- 3) A client exercises direct or indirect control with another or others, cf. point 2 a), when:
 - a) the client has influence corresponding to the direct or indirect influence of a parent undertaking in a group, cf. the connections mentioned in section 5(1), no. 7 of the Financial Business Act, or
 - b) the client has competence to coordinate the management of an undertaking with the management of another undertaking to reach a common goal, for example, if the same person is involved with the management or the board of directors of two or more undertakings.
- 4) It follows from the control criterion in point 2 a) that a client may be covered by two or more otherwise independent groups of mutually connected clients, for example if:
 - a) a client is 50 percent owned by two otherwise independent clients,
 - b) there is an ownership agreement, which ensures the participants a majority vote so that all the otherwise independent clients are each considered to have controlling influence over the company, or
 - c) a client is a partner in more than one partnership where the client has controlling influence together with the other partners.
- 5) It follows from the control criterion in point 2 a) that entities administered by the same entity or person shall be regarded as mutually connected clients. The administering entity or person may have its function either through mutual agreement between the administering entities, through articles of association or if there are personal links in the management. This does not apply, however, if the administering entity is a government body, a local authority or a regional authority with zero-weighting status according to the standard method for credit risk, cf. Annex 3 to the Executive Order on Capital Adequacy.
- 6) The control criterion defined in point 2 a) shall not cover conditions of temporary controlling interest but rather reflect a long-term relationship. Voluntary waiver to exercise controlling interest in the form of, for example, declarations, shall not exempt an undertaking from treating clients as connected.

Financial interconnectedness (re. point 2 b))

- 7) Financial interconnectedness in point 2 b) shall cover mutual interconnectedness between clients due to a client's dependence on another client's credit quality or due to clients being exposed to the same specific risk factors such as, for example, dependence on the same main supplier, the same main buyer or the same source of financing. Financial interconnectedness in point 3 b) however, shall not include clients exposed to the same general risks, such as for example clients situated in the same geographical area or belonging to the same sector.
- 8) Financial interconnectedness in point 2 b) presupposes common risks or dependence, which the client cannot avoid or overcome without falling into payment difficulties.

Furthermore, the risk or dependence shall be of such nature that the triggering factor shall entail great risk of the client's winding-up.

- 9) The undertaking shall be particularly aware of possible financial interconnectedness between clients in the following cases:
 - a) If a client has guaranteed another client's exposure wholly or partly, or if a client in other ways has made a commitment to another client's exposure, and if the exposure has such size that the guarantor is likely to breach his commitments to the undertaking in the event of requirements arising under the guarantee or commitment.
 - b) The owner of a property and the lessee who pays part of the rent, and if the rent income is a primary source of income for the owner, and if it is difficult to find new lessees.
 - c) A borrower and his client, if a significant part of the sale is made to a single client who is difficult to replace.
 - d) A manufacturer and dealer responsible for a significant part of the manufacturer's turnover, and if finding a new manufacturer or dealer, respectively is time-consuming.
 - e) Borrowers with joint client base and a very small number of clients and where there are limited possibilities for borrowers to find new clients.
 - f) If the undertaking becomes aware that another financial undertaking is treating two or more clients as mutually connected.
 - g) For retail clients:
 - i. A borrower and its co-borrowers.
 - ii. Cohabitees.
- 10) Financial interconnectedness due to the same source of financing arises if two or more clients receive all or the main part of their financing from a joint source, which cannot, or which can only with difficulty, be replaced, and if the cessation of the source of financing entails high probability of default. Two clients who have the same bank shall not constitute financial interconnectedness as the bank may usually be replaced without threatening the clients' solvency. If two or more clients are financing their undertaking by issuing securities on the same market, this shall not constitute mutual interconnectedness either, unless they have the same investor or the same small group of investors who cannot or who can only with difficulty, be replaced.
- 11) Financial interconnectedness due to the same source of financing may also exist for legal entities with a special purpose (SPVs), established by the same bank (or the undertaking itself). This is the case if the SPVs are dependent on liquidity facilities or guarantees from the same bank which can only with difficulty be replaced, or if the SPVs in question require regular refinancing by issuing securities or money-market instruments (commercial papers) through a given bank which can only with difficulty be replaced.

Procedures and checks for identification of mutually connected clients

- 12) Identification of possible mutual interconnectedness between clients shall be an integral part of the credit-approval process and monitoring of the credit area, and included in order to gain an overview and understanding of the undertaking's concentrations of risks. The greater the exposure with a single client, the more intensively the undertaking shall examine possible interconnectedness with other clients. The undertaking shall document its studies of possible interconnectedness to other clients for all exposures which exceed 2 percent of the capital base.
- 13) It is not a requirement that the undertaking systematically collect information on whether clients of the undertaking share a common source of financing but the undertaking shall utilise available information in this area.
- 14) The undertaking shall use available public information and utilise the knowledge that employees of the undertaking have acquired in order to identify mutual interconnectedness between clients. The undertaking shall also take measures to ensure that collecting information about mutual interconnectedness between clients is done to a reasonable extent, depending on the size of the client's exposure and risk.
- 15) The undertaking shall be able to establish that its procedures to identify mutual interconnectedness between clients are appropriately matched with its activities and client

base. The procedures shall be regularly updated. The undertaking shall ensure that the credit employees and risk-monitoring employees of the undertaking have the training required to be able to identify mutual interconnectedness between clients.

- 16) The undertaking shall monitor possible changes in mutual interconnectedness between clients during the periodical exposure review and in connection with significant expansion of exposures.
- 17) If the undertaking has information about mutual interconnectedness between clients, this information shall always be utilised, irrespective of the size of the client's exposure.

Schemes with underlying exposures

- 1) This Annex includes provisions on calculation of indirect exposures in connection with collective investment schemes and securitisations that include underlying exposures, cf. section 3(3).
- 2) The undertaking shall examine underlying exposures in collective investment schemes and securitisations in order to identify where these are interconnected with other exposures of the undertaking, including underlying exposures in other schemes with underlying exposures. The undertaking shall use one of the following methods:
 - a) Method based on knowledge about the underlying exposures (look-through): The undertaking shall identify and regularly monitor which clients are behind the underlying exposures and consolidate such exposures with the undertaking's other exposures with the same client.
 - b) Method based on partial knowledge about the underlying exposures: The undertaking uses look-through, as described in a), on the underlying exposures, where the undertaking knows the identity of the clients behind the exposures and treats the remaining exposures as unknown exposures in accordance with the method in c) below.
 - c) Method based on no knowledge about underlying exposures: If the largest exposure in the scheme represents less than 5 percent of all exposures in the scheme together, the undertaking may disregard a possible interconnectedness between the clients behind the underlying exposures in the scheme and the other clients of the undertaking. If the largest exposure in the scheme represents 5 percent or more of all exposures in the scheme together, or if the undertaking cannot exclude this, the undertaking shall, however, treat all clients behind the exposures in the scheme as one single unknown client. The unknown client shall then be treated as mutually connected with all other unknown clients, calculated similar to other schemes with unknown underlying exposures.
 - d) Method based on knowledge about the investment policy of the scheme: The undertaking may treat the scheme as a separate risk, independent of other exposures of the undertaking, if it can show, e.g. through prospectuses or articles of association for the scheme, that none of the clients behind the underlying exposures in the scheme, neither directly nor indirectly, are connected with other clients in the portfolio of the undertaking with an exposure of more than 2 percent of the undertaking's capital base, including other clients behind underlying exposures in other schemes.
- 3) Regardless of the treatment of the underlying exposures in a scheme with underlying exposures, the undertaking shall also treat the scheme as a single risk, corresponding to all the underlying exposures in the scheme being mutually connected.
- 4) The undertaking shall be able to ensure that a selection of the method in point 2 c) based on no knowledge about the underlying exposures is not based on an interest in avoiding consolidation of the underlying exposures in the scheme with the undertaking's direct exposures with clients.
- 5) The undertaking shall use the following principles when the methods in point 2 are used:
 - a) For schemes with underlying exposures where the underlying exposures themselves are schemes with underlying exposures, the criterion in point 2 c) shall, in the assessment of whether the largest exposure in the scheme makes up less than 5 percent of all exposures, be measured based on the underlying exposures in the underlying schemes.
 - b) Monitoring shall take place regularly and at least once a month.
 - c) For collective investment schemes that are not securitisations, the size of the underlying exposures in the scheme shall be calculated proportionally in accordance with the size of the undertaking's total exposure with the scheme.

- d) For schemes that are securitisations, the underlying exposures shall be calculated with the full amount at which they are included in the securitisation, however, as a maximum, with an amount corresponding to the size of the undertaking's total exposure with the securitisation, cf. however e).
 - e) For schemes that are securitisations, the undertaking may calculate the effect of the credit protection which subordinate tranches not held by the undertaking itself give for senior tranches. Each of the underlying exposures, calculated according to one of the methods in point 3, may thus be reduced by the size of subordinate tranches in the securitisation not held by the undertaking itself.
- 6) An undertaking which reduces the underlying exposures in securitisations in accordance with the method in point 5 e) shall regularly monitor changes in the size of subordinate tranches not held by the undertaking itself. The undertaking shall be able to document its ability to carry out such regular monitoring and duly adjust the size of its exposures in proportion to the limits in section 145 of the Financial Business Act, if credit protection from subordinate tranches lapses due to losses in the subordinate exposures.

Calculation of capital requirements for exceeding the large exposure limits

- 1) This Annex includes provisions on calculating supplementary capital requirements for exposures that exceed the exposure limits in section 145(1) and (2) of the Financial Business Act, cf. section 10(3), no. 2.
- 2) The excess of the exposure limit shall be calculated by selecting the parts of the total exposure in the trading book for the client or the group of mutually connected clients with the highest risk-weight for specific risk according to Annex 12, points 42-57 to the Executive Order on Capital Adequacy, or, where relevant, the highest risk-weight for counterparty risk according to Annex 16 to the Executive Order on Capital Adequacy so that the sum of selected parts of the exposure corresponds to the total excess of the exposure limit.
- 3) If the excess has lasted 10 days or less, the supplementary capital requirement for the excess shall be calculated as an addition of 200 percent of the risk-weighted items connected with the individual parts of the exposure, selected in accordance with point 2.
- 4) If the excess lasts for more than 10 days, the individual parts of the exposure selected in accordance with point 2, shall be distributed in the rows of table 1, so that the parts with the lowest risk-weight for specific risk according to Annex 12, points 42-60 to the Executive Order on Capital Adequacy, or, if relevant, the risk-weight for counterparty risk according to Annex 16 to the Executive Order on Capital Adequacy, are treated as the smallest excess, the parts with the second-smallest risk-weight as the second-smallest excess and similarly in increasing order. The supplement for risk-weighted items shall be calculated as the sum of the specific risk-weight according to Annex 12, points 42-60 to the Executive Order on Capital Adequacy, or where relevant, the risk-weight for counterparty risk according to Annex 16 to the Executive Order on Capital Adequacy multiplied against the corresponding factor in column 2 of table 1.

Table 1

Excess (calculated in % of capital base)	Multiplication factor
Up to 40%	200%
From 40% to 60%	300%
From 60% to 80%	400 %
From 80% to 100%	500 %
From 100% to 250%	600 %
More than 250%	900 %