

Pursuant to Article 161, paragraph (1), item (1) of the Credit Institutions Act (Official Gazette 117/2008) and Article 43, paragraph (2), item (9) of the Act on the Croatian National Bank (Official Gazette 75/2008), the Governor of the Croatian National Bank hereby issues the

DECISION
on own funds of credit institutions

I INTRODUCTION

Subject matter
Article 1

(1) This Decision prescribes:

- the characteristics and types of items included in the calculation of own funds; and
- the method and extent of the inclusion of particular items in the calculation of individual components of own funds.

(2) All credit institutions with registered offices in the Republic of Croatia and authorised by the Croatian National Bank shall comply with the provisions of this Decision, with the exception of electronic money institutions.

Definition of own funds
Article 2

(1) A credit institution's own funds shall be the amount of own funds that the credit institution is required to maintain in order to ensure safe and sound operations and to be able to meet obligations to its creditors.

(2) A credit institution's own funds shall be equal to the sum of original own funds and additional own funds, reduced by deduction items.

(3) By way of derogation from paragraph (2) of this Article, within the meaning of the provisions of the Credit Institutions Act governing large exposures and holdings in non-financial institutions and tangible assets, a credit institution's own funds shall be equal to the sum of original own funds and additional own funds, reduced by deduction items, but excluding from the calculation of additional own funds the item referred to in Article 15, item (4) of this Decision and excluding from deduction items the items referred to in Article 27, paragraph (1), items (6) and (7) of this Decision.

(4) By way of derogation from paragraphs (2) and (3) of this Article, own funds of a credit institution which uses ancillary own funds to cover the capital requirements for market risks shall be equal to the sum of original own funds, additional own funds and

ancillary own funds, reduced by deduction items. The calculation of own funds as defined in this paragraph shall be applied only for the purpose of covering the capital requirements for market risks and the calculation of the capital adequacy ratio.

II ORIGINAL OWN FUNDS

**Original own funds
Article 3**

A credit institution may include individual items in the calculation of its original own funds provided that all of the following conditions are met:

- 1) during the credit institution's operation, they are freely and fully available to the credit institution for unrestricted and immediate use to cover risks or losses;
- 2) in the event of the opening of bankruptcy proceedings or the initiation of the winding-up of the credit institution, they are fully available to the credit institution for unrestricted use to cover its losses after the claims of all other creditors have been settled; and
- 3) their amount shall be net of any foreseeable tax charge.

**Composition of original own funds
Article 4**

Original own funds shall be equal to the sum of the items referred to in Article 5 of this Decision reduced by the sum of the items referred to in Article 6 of this Decision.

**Items included in original own funds
Article 5**

A credit institution shall include the following items in its original own funds:

- 1) paid-up capital from the issue of shares of the credit institution, excluding cumulative preferential shares;
- 2) reserves and retained earnings; and
- 3) reserves for general banking risks.

**Items reducing original own funds
Article 6**

- (1) A credit institution shall reduce its original own funds by the following items:
 - 1) losses brought forward;
 - 2) losses for the current year;

- 3) own shares;
- 4) intangible assets;
- 5) the outstanding amount of credits which the credit institution granted for the purchase of its shares, excluding cumulative preferential shares, in accordance with Article 12 of this Decision; and
- 6) other items referred to in Article 13 of this Decision.

(2) A credit institution which granted a credit for the purchase of its shares, excluding cumulative preferential shares, and which has taken in pledge its shares as collateral for that credit, shall calculate its original own funds as follows:

- 1) reduce original own funds only by the item referred to in paragraph (1), item (3) of this Article, provided that this amount is greater than or equal to the amount referred to in paragraph (1), item (5) of this Article; or
- 2) reduce original own funds by the total amount of the item referred to in paragraph (1), item (3) of this Article and by the item referred to in paragraph (1), item (5) of this Article in the amount of the difference between the total amount of that item and the amount of the item referred to in paragraph (1), item (3) of this Article, provided that the amount of the item referred to in paragraph (1), item (3) of this Article is less than the amount of the item referred to in paragraph (1), item (5) of this Article.

Issued shares

Article 7

A credit institution shall include the following in the amount of the paid-up capital from the issue of shares, excluding cumulative preferential shares:

- 1) the nominal value of paid-up ordinary and preferential shares but excluding cumulative preferential shares; and
- 2) share premium accounts but excluding share premium accounts related to cumulative preferential shares.

Reserves and retained earnings

Article 8

(1) The amount of the reserves referred to in Article 5, item (2) of this Decision shall relate to all types of the credit institution's reserves made from profit after tax, including:

- 1) legal reserves, determined in the manner prescribed in the Companies Act;
- 2) reserves provided for by the credit institution's Articles of Association, determined in the manner prescribed in the Companies Act;
- 3) reserves for own shares and for shares considered own in accordance with the provisions of the Companies Act, stating total reserves for own shares acquired by the credit institution itself, own shares acquired through third parties and own shares taken in pledge; reserves for own shares acquired by the credit institution

itself and own shares acquired through third parties shall be made in the amount paid for the acquisition of own shares, and reserves for own shares taken in pledge, directly or indirectly, shall be made in the nominal amount of shares; and

4) other reserves, determined in the manner prescribed in the Companies Act.

(2) The amount of reserves shall be increased by capital gains on the purchase and sale of a credit institution's own shares and reduced by capital losses on the purchase and sale of a credit institution's own shares.

(3) The amount of the retained earnings referred to in Article 5, item (2) of this Decision shall relate to the part of previous years' retained earnings confirmed at the credit institution's general meeting, presented in the balance sheet and net of provisions for future charges.

(4) Where own funds are calculated on the basis of interim financial statements, the retained earnings item may include profit for the current year in whole or in part, provided that all of the following conditions are met:

- 1) it has been decided at the general meeting that profit for the current year be allocated, in whole or in part, to reserves or retained earnings or to the increase in share capital (with the exception of cumulative preferential shares), or the management and supervisory boards have decided to allocate profit for the current year, in whole or in part, to other reserves from profit;
- 2) the amount of profit for the current year must be net of profit tax and other foreseeable charges;
- 3) the profit has been verified by an external auditor;
- 4) it is evident from the credit institution's track record that it operated in compliance with standards of safe and sound operation; and
- 5) the credit institution obtained prior approval from the Croatian National Bank.

(5) Where own funds are calculated on the basis of audited financial statements, the retained earnings item may include profit for the current year in whole or in part, provided that all of the following conditions are met:

- 1) it has been decided at the general meeting that profit for the current year be allocated, in whole or in part, to reserves or retained earnings or to the increase in share capital (with the exception of cumulative preferential shares), or the management and supervisory boards have decided to allocate profit for the current year, in whole or in part, to other reserves from profit; and
- 2) the amount of profit for the current year must be net of profit tax and other foreseeable charges.

(6) When adopting the decisions referred to in paragraph (4), item (1) and paragraph (5), item (1) of this Article, the general meeting, and the management and supervisory

boards shall state the amount of profit for the current year to be allocated to reserves or retained earnings or to the increase in share capital (with the exception of cumulative preferential shares) as percentage of profit for the current year.

(7) In the case of a credit institution which is the originator of a securitisation, net gains arising from the capitalisation of future income from the securitised assets and providing credit enhancement to positions in the securitisation shall be excluded from the amount of reserves and retained earnings.

Reserves for general banking risks

Article 9

Reserves for general banking risks shall be the reserves prescribed by the Croatian National Bank in subordinate legislation.

Own shares

Article 10

Own shares shall be acquired own shares and shares considered own in accordance with the provisions of the Companies Act, excluding cumulative preferential shares. Acquired own shares and own shares acquired through third parties shall be stated at cost and own shares held in pledge shall be stated at their nominal value.

Intangible assets

Article 11

(1) For the purposes of this Decision, intangible assets shall include all of the following items:

- 1) formation expenses,
- 2) concessions,
- 3) patents,
- 4) licences,
- 5) trade marks,
- 6) goodwill,
- 7) payments on account for the items referred to in items (2) to (5) of this paragraph; and
- 8) positive revaluation reserves from revaluation of intangible assets.

(2) For the purposes of this Decision, software and software in development shall not be included in intangible assets.

(3) Intangible assets shall be stated at net value, i.e. net of accumulated amortisation and other value adjustments.

Outstanding amount of credits for the purchase of shares of a credit institution

Article 12

(1) The outstanding amount of credits for the purchase of shares of a credit institution shall be the outstanding amount of credits which a credit institution granted, directly or indirectly, for the purchase of its shares, excluding cumulative preferential shares.

(2) All legal arrangements the economic substance of which is equivalent to credit, as well as guarantees or other commitments issued for such credits shall be deemed to be the granting of credits referred to in paragraph (1) of this Article. Where such credits have been impaired in accordance with the Decision on the classification of placements and off-balance sheet liabilities of credit institutions, the credit institution shall state the estimated recoverable amount of the credit. Where provisions for the stated guarantees or other commitments have been made in accordance with the Decision on the classification of placements and off-balance sheet liabilities of credit institutions, the credit institution shall state the amount net of provisions.

Other items reducing original own funds

Article 13

(1) Other items reducing original own funds shall be:

- 1) unrealised losses on revaluation of available for sale financial assets;
- 2) the portion of the loss on the hedging instrument related to a cash flow hedge that is determined to be an effective hedge;
- 3) the portion of the loss on the hedging instrument related to a hedge of a net investment in a legal person having its registered office outside the Republic of Croatia (a foreign operation) that is determined to be an effective hedge;
- 4) gains on liabilities valued at fair value that are due to changes in a credit institution's own credit standing;
- 5) cumulative expense relating to a non-current asset or disposal group held for sale;
- 6) negative net revaluation reserves arising from accounting for investments in associates and joint ventures using the equity method; and
- 7) other negative net revaluation reserves.

(2) Positive revaluation reserves shall not be included in the calculation of own funds, with the exception of the item referred to in Article 11, paragraph (1), item (8) of this Decision.

III ADDITIONAL OWN FUNDS

Composition of additional own funds

Article 14

Additional own funds shall be equal to the sum of the items referred to in Article 15 of this Decision reduced by the sum of the items referred to in Article 16 of this Decision.

Items included in additional own funds

Article 15

A credit institution shall include the following items in its additional own funds:

- 1) paid-up capital from the issue of cumulative preferential shares;
- 2) hybrid instruments;
- 3) subordinated instruments; and
- 4) a positive difference between value adjustments and provisions and expected loss.

Items reducing additional own funds

Article 16

(1) A credit institution shall reduce its additional own funds by the following items:

- 1) own cumulative preferential shares;
- 2) claims and contingent liabilities secured by hybrid or subordinated instruments of the credit institution; and
- 3) the outstanding amount of credits which the credit institution granted for the purchase of its cumulative preferential shares.

(2) A credit institution which granted a credit for the purchase of its cumulative preferential shares, and which has taken in pledge its cumulative preferential shares as collateral for that credit, shall calculate its additional own funds as follows:

- 1) reduce additional own funds only by its own cumulative preferential shares, provided that their amount is greater than or equal to the amount referred to in paragraph (1), item (3) of this Article; or
- 2) reduce additional own funds by the total amount of its own cumulative preferential shares and by the item referred to in paragraph (1), item (3) of this Article in the amount of the difference between the total amount of that item and its own cumulative preferential shares, provided that the amount of its own cumulative preferential shares is less than the amount of the item referred to in paragraph (1), item (3) of this Article.

Cumulative preferential shares

Article 17

The amount of the paid-up capital from the issue of cumulative preferential shares shall consist of:

- 1) the nominal value of paid-up cumulative preferential shares; and
- 2) share premium accounts related to cumulative preferential shares.

Hybrid instruments

Article 18

(1) Hybrid instruments are financial instruments for raising funds that combine the features of both debt and equity. A credit institution shall include in its additional own funds hybrid instruments that meet the conditions for inclusion in additional own funds referred to in paragraph (4) of this Article.

(2) A credit institution intending to include a hybrid instrument in its additional own funds shall notify the Croatian National Bank at least 30 days before the intended inclusion.

(3) A credit institution shall enclose the following documentation with the notification referred to in paragraph (2) of this Article:

- 1) the basic documentation (contract, prospectus, etc.) associated with the issue of the hybrid instrument in question;
- 2) a description of the accounting treatment of the hybrid instrument in question;
- 3) the calculation of own funds and capital requirements as at the last day of the month before delivery of the notification; and
- 4) a projection of own funds and capital requirements for the next three years.

(4) Hybrid instruments, regardless of their form or name, must meet the following conditions for inclusion in additional own funds:

- 1) they are issued by the credit institution that intends to include them in the calculation of additional own funds;
- 2) they are fully paid-up;
- 3) they have a fixed maturity of more than six years counting from the payment date;
- 4) they may not be repaid or repurchased by the credit institution before maturity except when converted to the credit institution's shares, excluding cumulative preferential shares;
- 5) in the event of the bankruptcy or winding-up of the credit institution, they rank after the claims of all other creditors and are repaid only after the claims of all other creditors have been settled;

- 6) they are freely available to cover operating losses as well as in the event of the bankruptcy or winding-up;
- 7) the credit institution has the option of deferring the payment of interest or fees on such instruments;
- 8) they are unsecured, i.e. they are not additionally secured by the credit institution's guarantees, mortgages or otherwise;
- 9) if the credit institution's own funds fall below the amount prescribed in Article 131 of the Credit Institutions Act (or another amount determined by the Croatian National Bank in accordance with Article 237 of the Credit Institutions Act), the credit institution may not pay interest, fees or other income on such instruments until it has attained the prescribed amount;
- 10) if the credit institution fails to increase its initial capital within 90 days after it was established that its own funds fell below 75% of the amount prescribed in Article 131 of the Credit Institutions Act (or another amount determined by the Croatian National Bank in accordance with Article 237 of the Credit Institutions Act), the credit institution shall convert these instruments into shares that are included in original own funds in accordance with predetermined conditions;
- 11) the legal basis governing the relationship between the holder of the hybrid instrument and the credit institution (contract, prospectus, etc.) must be concluded in writing and contain all the conditions prescribed in this paragraph, as well as a note explaining that the instrument does not constitute a deposit and that it is not secured by the institution responsible for deposit insurance; and
- 12) the name of the instrument and the legal basis referred to in item (11) of this paragraph may not contain the word "savings" or any derivative thereof.

(5) Credit institutions may include hybrid instruments that are payable by instalments in their additional own funds, provided that the first instalment does not become due within a period of less than six years counting from the payment date.

(6) Credit institutions shall exclude from their additional own funds hybrid instruments that no longer meet the conditions referred to in paragraph (4) of this Article.

(7) Credit institutions shall notify the Croatian National Bank without delay of any changes in the legal basis referred to in paragraph (4), item (11) of this Article.

(8) In the calculation of additional own funds hybrid instruments shall be included in whole if there is more than one year remaining to their maturity date. In the last year before maturity hybrid instruments shall not be included in additional own funds.

(9) Where a credit institution issued securities for the purpose of raising hybrid instruments, it shall apply a nominal value of the securities reduced by discount in the calculation of additional own funds.

(10) Funds raised by hybrid instruments contrary to the provisions of Article 31, paragraph (3) of the Credit Institutions Act shall not be included in the calculation of own funds. Other legal arrangements the economic substance of which is equivalent to credit, as well as guarantees or other commitments issued for such credits shall be deemed to be the granting of credits.

Subordinated instruments

Article 19

(1) Subordinated instruments are financial instruments for raising funds. A credit institution shall include in its additional own funds subordinated instruments that meet the conditions for inclusion in additional own funds referred to in paragraph (4) of this Article.

(2) A credit institution intending to include a subordinated instrument in its additional own funds shall notify the Croatian National Bank at least 30 days before the intended inclusion.

(3) A credit institution shall enclose the following documentation with the notification referred to in paragraph (2) of this Article:

- 1) the basic documentation (contract, prospectus, etc.) associated with the issue of the subordinated instrument in question;
- 2) the calculation of own funds and capital requirements as at the last day of the month before delivery of the notification; and
- 3) a projection of own funds and capital requirements for the next three years.

(4) Subordinated instruments, regardless of their form or name, must meet the following conditions for inclusion in additional own funds:

- 1) they are issued by the credit institution that intends to include them in the calculation of additional own funds;
- 2) they are fully paid-up;
- 3) they have a fixed maturity of more than five years counting from the payment date;
- 4) they may not be repaid or repurchased by the credit institution before maturity except when converted to the credit institution's shares, excluding cumulative preferential shares;
- 5) in the event of the bankruptcy or winding-up of the credit institution, they rank after the claims of all other creditors and are repaid only after the claims of all other creditors have been settled, but before the settlement of the claims of holders of hybrid instruments;
- 6) they are available to cover losses only in the event of the bankruptcy or winding-up of the credit institution and are not available to cover losses in the normal course of business of the credit institution;

- 7) they are unsecured, i.e. they are not additionally secured by the credit institution's guarantees, mortgages or otherwise;
- 8) the legal basis governing the relationship between the holder of the subordinated instrument and the credit institution (contract, prospectus, etc.) must be concluded in writing and contain all the conditions prescribed in this paragraph, as well as a note explaining that the instrument does not constitute a deposit and that it is not secured by the institution responsible for deposit insurance; and
- 9) the name of the instrument and the legal basis referred to in item (8) of this paragraph may not contain the word "savings" or any derivative thereof.

(5) Credit institutions may include subordinated instruments that are payable by instalments in their additional own funds, provided that the first instalment does not become due within a period of less than five years counting from the payment date.

(6) Credit institutions shall exclude from their additional own funds subordinated instruments that no longer meet the conditions referred to in paragraph (4) of this Article.

(7) Credit institutions shall notify the Croatian National Bank without delay of any changes in the legal basis referred to in paragraph (4), item (8) of this Article.

(8) The amount of subordinated instruments included in the calculation of own funds shall be reduced by a cumulative 20% annual discount rate in the last five years before maturity as follows:

- 1) in the calculation of own funds as at a day when there is more than five years remaining to the maturity date of the instrument, 100% of the amount of the respective subordinated instrument shall be included in additional own funds;
- 2) in the calculation of own funds as at a day when there is five years or less than five years but more than four years remaining to the maturity date of the instrument, 80% of the amount of the respective subordinated instrument shall be included in additional own funds;
- 3) in the calculation of own funds as at a day when there is four years or less than four years but more than three years remaining to the maturity date of the instrument, 60% of the amount of the respective subordinated instrument shall be included in additional own funds;
- 4) in the calculation of own funds as at a day when there is three years or less than three years but more than two years remaining to the maturity date of the instrument, 40% of the amount of the respective subordinated instrument shall be included in additional own funds;
- 5) in the calculation of own funds as at a day when there is two years or less than two years but more than one year remaining to the maturity date of the instrument, 20% of the amount of the respective subordinated instrument shall be included in additional own funds;

6) subordinated instruments with a remaining maturity of less than one year shall not be included in additional own funds.

(9) Where a credit institution issued securities as subordinated instruments, it shall apply the discount in accordance with paragraph (8) of this Article in the calculation of additional own funds.

(10) Funds raised by subordinated instruments contrary to the provisions of Article 31, paragraph (3) of the Credit Institutions Act shall not be included in the calculation of own funds. Other legal arrangements the economic substance of which is equivalent to credit, as well as guarantees or other commitments issued for such credits shall be deemed to be the granting of credits.

Positive difference between value adjustments and provisions and expected loss

Article 20

(1) A positive difference between value adjustments and provisions and expected loss shall be the positive amount arising from the calculation referred to in Article 326 of the Decision on the capital adequacy of credit institutions up to the amount of 0.6% of risk-weighted exposure amounts for credit risk calculated under the IRB Approach. Only credit institutions calculating risk-weighted exposure amounts for credit risk under the IRB Approach shall include this item in additional own funds.

(2) For the purposes of the calculation referred to in Article 326 of the Decision on the capital adequacy of credit institutions, the following shall apply to credit institutions calculating risk-weighted exposure amounts for settlement and counterparty risk under the IRB Approach:

- 1) value adjustments made to account for the credit quality of the counterparty may be included in the sum of value adjustments and provisions made for exposures to settlement and counterparty risk;
- 2) the expected loss amount for the counterparty risk exposure shall be zero, subject to the prior approval of the Croatian National Bank and provided that the credit risk of the counterparty has been adequately taken into account in the valuation of a position included in the trading book.

(3) For credit institutions calculating risk-weighted exposure amounts for credit risk under the IRB Approach value adjustments and provisions included in the calculation referred to in Article 326 of the Decision on the capital adequacy of credit institutions shall not be included in the calculation of own funds other than in accordance with this Article.

(4) The risk-weighted exposure amounts for credit risk referred to in paragraph (1) of this Article shall not include those calculated in respect of securitisation positions which receive a risk weight of 1250%.

Own cumulative preferential shares

Article 21

Own cumulative preferential shares shall be acquired own cumulative preferential shares and cumulative preferential shares considered own in accordance with the provisions of the Companies Act. Acquired own cumulative preferential shares and own cumulative preferential shares acquired through third parties shall be stated at cost and own cumulative preferential shares held in pledge shall be stated at their nominal value.

Claims and contingent liabilities secured by hybrid or subordinated instruments

Article 22

Claims and contingent liabilities secured by hybrid or subordinated instruments of a credit institution shall be claims and contingent liabilities secured by hybrid or subordinated instruments that are components of a credit institution's additional own funds up to the amount these instruments are included in the credit institution's own funds. Where such claims have been impaired in accordance with the Decision on the classification of placements and off-balance sheet liabilities of credit institutions, the credit institution shall state the estimated recoverable amount. Where provisions for the stated contingent liabilities have been made in accordance with the Decision on the classification of placements and off-balance sheet liabilities of credit institutions, the credit institution shall state the amount net of provisions.

Outstanding amount of credits for the purchase of cumulative preferential shares of a credit institution

Article 23

The outstanding amount of credits which a credit institution granted, directly or indirectly, for the purchase of its cumulative preferential shares shall also include other legal arrangements the economic substance of which is equivalent to credit, as well as guarantees or other commitments issued for such credits. Where such credits have been impaired in accordance with the Decision on the classification of placements and off-balance sheet liabilities of credit institutions, the credit institution shall state the estimated recoverable amount of the credit. Where provisions for the stated guarantees or other commitments have been made in accordance with the Decision on the classification of placements and off-balance sheet liabilities of credit institutions, the credit institution shall state the amount net of provisions.

IV ANCILLARY OWN FUNDS

Composition of ancillary own funds

Article 24

(1) Ancillary own funds shall consist of subordinated instruments that are financial instruments issued for raising funds, which must meet the following conditions, regardless of their form or name:

- 1) they are issued by the credit institution that intends to include them in the calculation of ancillary own funds;
- 2) they are fully paid-up;
- 3) they have a fixed maturity of more than two years counting from the payment date;
- 4) they may not be repaid or repurchased by the credit institution before maturity except when converted to the credit institution's shares, excluding cumulative preferential shares;
- 5) they are unsecured, i.e. they are not additionally secured by the credit institution's guarantees, mortgages or otherwise;
- 6) in the event of the bankruptcy or winding-up of the credit institution, they rank after the claims of all other creditors and are repaid only after the claims of all other creditors have been settled, but before the settlement of the claims of holders of subordinated or hybrid instruments;
- 7) the legal basis governing the relationship between the holder of the instrument and the credit institution (contract, prospectus, etc.) contains a clause prohibiting the payment of interest and principal (even at maturity) where such payment would mean that the credit institution's own funds would fall below the amount of total capital requirements calculated in accordance with Article 131, paragraph (1) of the Credit Institutions Act;
- 8) the legal basis of the instrument referred to in item (7) of this paragraph contains a clause providing that when the credit institution's own funds fall below 75% of the amount prescribed in Article 131 of the Credit Institutions Act (or another amount determined by the Croatian National Bank in accordance with Article 237 of the Credit Institutions Act), the credit institution must convert the instrument into a component of its original own funds and thus cover losses;
- 9) the legal basis of the instrument referred to in item (7) of this paragraph must be concluded in writing and contain all the conditions prescribed in this paragraph, as well as a note explaining that the instrument does not constitute a deposit and that it is not secured by the institution responsible for deposit insurance; and
- 10) the name of the instrument and the legal basis referred to in item (7) of this paragraph may not contain the word "savings" or any derivative thereof.

(2) Credit institutions shall exclude from ancillary own funds subordinated instruments that no longer meet the conditions referred to in paragraph (1) of this Article.

(3) Credit institutions shall notify the Croatian National Bank without delay of any changes in the legal basis referred to in paragraph (1), item (7) of this Article.

(4) Subordinated instruments used to secure claims or contingent liabilities of a credit institution shall not be included in ancillary own funds.

(5) Funds raised by subordinated instruments contrary to the provisions of Article 31, paragraph (3) of the Credit Institutions Act shall not be included in the calculation of own funds. Other legal arrangements the economic substance of which is equivalent to credit, as well as guarantees or other commitments issued for such credits shall be deemed to be the granting of credits.

(6) A credit institution shall notify the Croatian National Bank without delay of any payment under the subordinated instrument referred to in this Article if its own funds fall below 120% of total capital requirements calculated in accordance with Article 131, paragraph (1) of the Credit Institutions Act.

V LIMITS IN THE CALCULATION OF OWN FUNDS

Limits in the calculation of own funds

Article 25

(1) A credit institution may not use any component of its own funds to simultaneously cover different capital requirements calculated in accordance with the Decision on the capital adequacy of credit institutions.

(2) A credit institution may use its original own funds and additional own funds to cover the capital requirements for credit risk, operational risk and market risks. For this purpose, original own funds shall be appropriately reduced by deduction items in accordance with Article 26, paragraph (3) of this Decision and additional own funds shall be appropriately reduced by deduction items in accordance with Article 26, paragraph (3) of this Decision. Ancillary own funds may be used only to cover the capital requirements for market risks.

(3) The total sum of additional own funds and ancillary own funds may not exceed the amount of original own funds.

(4) The amount of subordinated instruments included in additional own funds may not exceed 50% of original own funds.

(5) Ancillary own funds may be included in the calculation of own funds up to the amount that is used to cover the capital requirements for market risks but may not exceed a maximum of 150% of original own funds, appropriately reduced by deduction items in accordance with Article 26, paragraph (3) of this Decision, that is left to cover the capital requirements for market risks and not used to cover any other risks.

VI DEDUCTION ITEMS

Composition of deduction items

Article 26

- (1) Deduction items shall be equal to the sum of the items defined in Article 27 of this Decision.
- (2) A credit institution shall reduce its own funds by deduction items, after application of the limits laid down in Article 25 of this Decision.
- (3) The total of the deduction items shall be deducted half from original own funds and half from additional own funds. To the extent that half of deduction items exceeds the amount of additional own funds, the excess shall be deducted from original own funds.

Deduction items

Article 27

- (1) The following items shall be deducted from a credit institution's own funds:
 - 1) direct or indirect holdings in other credit and financial institutions exceeding 10% of the capital in each case;
 - 2) subordinated and hybrid instruments which a credit institution holds in respect of other credit and financial institutions in which it has direct or indirect holdings exceeding 10% of the capital in each case;
 - 3) the total amount of direct or indirect holdings in other credit and financial institutions of up to 10% of their capital, and subordinated and hybrid instruments which a credit institution holds in respect of credit and financial institutions other than those referred to in item (2) of this paragraph, which exceed 10% of the sum of that credit institution's original own funds and additional own funds (without taking account of deduction items);
 - 4) direct or indirect holdings in insurance undertakings, reinsurance undertakings and insurance holding companies exceeding 10% of the capital in each case;
 - 5) instruments which a credit institution holds and which are, in accordance with the law governing insurance, included in the calculation of additional own funds of insurance undertakings, reinsurance undertakings and insurance holding companies in which it has direct or indirect holdings exceeding 10% of the capital in each case;
 - 6) a negative difference between value adjustments and provisions and expected loss, as well as expected loss amounts for equity exposures;
 - 7) the exposure amount of securitisation positions which receive a risk weight of 1250%;
 - 8) free deliveries;

- 9) claims on legal persons and contingent liabilities towards legal persons directly or indirectly controlled by the credit institution, provided that these claims and contingent liabilities were established under terms more favourable than those normally offered by the credit institution, or more favourable than those prevailing in the financial markets for comparable operations, or under terms that are not in line with the principles of safe and sound operation;
- 10) claims on persons in a special relationship with the credit institution and contingent liabilities towards such persons, including craftsmen, freelancers and sole traders, provided that these claims and contingent liabilities were established under terms more favourable than those normally offered by the credit institution, or more favourable than those prevailing in the financial markets for comparable operations, or under terms that are not in line with the principles of safe and sound operation;
- 11) claims and contingent liabilities secured by shares of other credit institutions not listed on a recognised exchange; and
- 12) the amount of excess holdings in non-financial institutions.

(2) Where the claims referred to in paragraph (1) of this Article have been impaired in accordance with the Decision on the classification of placements and off-balance sheet liabilities of credit institutions, the credit institution shall state the estimated recoverable amount. Where provisions for the contingent liabilities referred to in paragraph (1) of this Article have been made in accordance with the Decision on the classification of placements and off-balance sheet liabilities of credit institutions, the credit institution shall state the amount net of provisions.

(3) A credit institution need not deduct from own funds shares or holdings in another credit institution, financial institution, insurance or reinsurance undertaking or insurance holding company held temporarily for the purposes of a financial assistance operation designed to reorganise and improve the position of that entity. The credit institution shall notify the Croatian National Bank thereof without delay and enclose the relevant documentation.

(4) Placements that a credit institution granted from the funds of international financial institutions and credits from the London and Paris Clubs shall not be included in deduction items.

Negative difference between value adjustments and provisions and expected loss

Article 28

(1) A negative difference between value adjustments and provisions and expected loss shall be the negative amount arising from the calculation referred to in Article 326 of the Decision on the capital adequacy of credit institutions.

(2) For the purposes of the calculation referred to in Article 326 of the Decision on the capital adequacy of credit institutions, the following shall apply to credit institutions calculating risk-weighted exposure amounts for settlement and counterparty risk under the IRB Approach:

- 1) value adjustments made to account for the credit quality of the counterparty may be included in the sum of value adjustments and provisions made for exposures to settlement and counterparty risk;
- 2) the expected loss amount for the counterparty risk exposure shall be zero, subject to the prior approval of the Croatian National Bank and provided that the credit risk of the counterparty has been adequately taken into account in the valuation of a position included in the trading book.

(3) Expected loss amounts for equity exposures shall be the expected loss amount calculated in accordance with Article 324, paragraphs (1) and (2) of the Decision on the capital adequacy of credit institutions.

(4) The items defined in this Article shall be accounted for only by credit institutions calculating risk-weighted exposure amounts for credit risk under the IRB Approach.

Exposure amount of securitisation positions

Article 29

The exposure amount of securitisation positions shall be the exposure amount of securitisation positions which receive a risk weight of 1250% in accordance with Article 460 of the Decision on the capital adequacy of credit institutions, provided that such securitisation positions are not included in the calculation of risk-weighted exposure amounts for credit risk.

Free deliveries

Article 30

Free deliveries shall be equal to the value transferred plus current positive exposure, provided that more than 4 business days have elapsed since the second contractual payment or delivery leg and the counterparty failed to meet its obligation, referred to in Article 482, paragraph (5) of the Decision on the capital adequacy of credit institutions.

Amount of excess holdings in non-financial institutions

Article 31

(1) A credit institution shall determine the amount of excess holdings in non-financial institutions by calculating its own funds as defined in Article 2, paragraph (3) of this Decision without taking account of the deduction item referred to in Article 27, paragraph (1), item (12) of this Decision; on the basis of the thus calculated amount of

own funds, a credit institution shall determine whether it breaches the limits on holdings in non-financial institutions prescribed in Article 157, paragraphs (1) and (2) of the Credit Institutions Act.

(2) Where a credit institution establishes that it breaches the limits on holdings in non-financial institutions referred to in Article 157, paragraphs (1) and (2) of the Credit Institutions Act, it shall deduct the excess amount in the calculation of own funds in accordance with Article 159 of the Credit Institutions Act.

VII TRANSITIONAL AND FINAL PROVISIONS

Article 32

(1) The instruments defined as hybrid or subordinated instruments under the provisions of Chapter 2 of the Decision on the capital adequacy of banks (Official Gazette 17/2003, 120/2003, 149/2005, 130/2006, 130/2007 and 31/2008) shall continue to be recognised as additional own funds until the last year before maturity.

(2) The instruments defined as instruments of ancillary own funds under the provisions of Chapter 2 of the Decision on the capital adequacy of banks (Official Gazette 17/2003, 120/2003, 149/2005, 130/2006, 130/2007 and 31/2008) shall continue to be recognised as ancillary own funds until maturity.

Article 33

Credit institutions shall report to the Croatian National Bank on their own funds within the time limits and in the manner and form prescribed in the Decision on reports on own funds and capital requirements of credit institutions.

Article 34

This Decision shall be published in the Official Gazette and shall enter into force on 1 July 2009.

No.: 2-020/01-09/ŽR
Zagreb, 2 January 2009

Croatian National Bank
Council Chairman
Governor
Željko Rohatinski, m.p.