Pursuant to Article 23, paragraph 1, Article 35, paragraph 1, subparagraph 1.1 of the Law No. 03/L-209 on the Central Bank of the Republic of Kosovo (Official Gazette of the Republic of Kosovo, No. 77/16, August, 2010), and Articles 15, 16 and 85 paragraph 1 of the Law No. 04/L-093 on Banks, Microfinance Institutions and Non-Bank Financial Institutions (Official Gazette of the Republic of Kosovo, No. 11/11, May, 2012), the Board of the Central Bank of the Republic of Kosovo at the meeting held on 22 December 2015, approved the following:

REGULATION
ON BANK CAPITAL ADEQUACY

Article 1
Purpose and Scope

1. The purpose of this Regulation is to ensure that banks hold sufficient capital to cover the risks involved in their business, to maintain the minimum capital level and also a capital adequacy ratio which reflects the risk exposures of the bank both on- and off-balance sheet.

2. This Regulation shall apply to all banks that are licensed by the CBK to operate in the Republic of Kosovo, excluding branches of foreign banks.

Article 2
Definitions

1. All terms used in this Regulation have the same meaning to the terms defined in Article 3 of the Law No.04/L-093 on Banks, Micro-finance Institutions and Non-Bank Financial Institutions and/or with definitions used for the purpose of this Regulation:

   a) Bank – means a shareholder company engaged in banking activity, including a subsidiary, licensed by the CBK;

   b) Branch of a foreign bank – means a person that is organized, has its head office and possesses a license to engage in the banking activity in a jurisdiction other than Kosovo.
c) **Common Equity Tier 1 capital** – means a bank’s permissible permanent paid-in capital which may be comprised by:

i. Common equity shares and their related surplus;
ii. Earnings which have not been distributed.

**Additional Tier 1 capital** – means:

i. perpetual preferred shares (those which, in the event of liquidation of the bank, are not paid any amounts until all depositors and other creditors have been paid entirely, but are paid in full (preferred) before any common shareholder is paid and has the right to agree on dividend payments but which has no maturities or options of their holders to redeem);

ii. other instruments that might get approved by CBK from time to time, as permissible permanent capital, by rule or order.

**Deductions from Tier 1 Capital:**

i. Goodwill and intangible assets are to be deducted from a bank’s Tier 1 capital before is calculated the portion of Tier 2 capital;

ii. Investments in equity of banks and other financial institutions that comprise above ten percent (10%) of their capital (including here also the subordinated rights), or investments in amounts less than 10% of their capital, but with a significant influence in decision-making of these institutions. Investments in equity of banks and other financial institutions (including here also the subordinated rights) that comprise less than 10% of the bank’s equity before deductions, where the portion above 10% of bank’s equity shall be deducted.;

iii. Deferred tax assets;

iv. Lending to a Bank-Related Person, except lending covered with cash.

d) **Bank’s Tier 2 capital includes:**

i. General reserves for loan losses up to a maximum of 1.25% (percent) of its risk weighted assets for credit risk, or other percentage that might be requested from time to time by the CBK by rule or order;

ii. Ordinary preferred shares (being preferred shares which have maturities or are redeemable at the option of their holders and which are cumulative (have the
right to pay the past dividends missed) if the bank has the option to defer payment of dividends;

iii. Term preferred shares (shares whose holders have the right to redeem them and which have terms of 5 years or more). These shares from time to time are subject of approval as capital throughout their terms by the CBK. The amount of long-term preferred shares (shares with maturities in excess of 10 years) that are eligible to be included in Tier 2 capital will be reduced by 20% (percent) of their original amounts at the beginning of each of the last 5 years of their terms;

iv. Term debt instruments which are fully subordinated to the rights of depositors (those which in the event of liquidation of the bank, are not paid any amounts until all depositors have been paid). The amount of long-term subordinated debt instruments (with maturities in excess of 10 years) that are eligible to be included in Tier 2 capital will be reduced by 20% (percent) of their original amounts at the beginning of each of the last 5 years of the instrument’s life;

v. Debt instruments which are mandatory convertible into common shares and which are unsecured and fully payable;

vi. Subordinated debt are liabilities, but if subordinated debt are with an original term of maturity of over 5 years, then they might be included as Tier 2 capital to a maximum of 50% of Tier 1 capital; and

vii. Tier 2 capital cannot be higher than 100% of Tier 1 capital.

e) Total capital – means the sum of Tier 1 capital and Tier 2 capital.

f) Risk-asset – means any monetary asset which is carried on the balance sheet of a bank such as e.g. a loan which entails any risk of loss in value to that bank.

g) Off-balance sheet items – means the contingent liabilities of a bank including direct credit substitutes issued by bank as guarantees of indebtedness, standby letters of credit and other contingencies which must be disclosed as footnotes on its balance sheet but for which no definite risk value is available for purposes of inclusion in the principle part of its balance sheet.
h) **Goodwill** – means the excess of the current value of a bank asset over the value at which it is carried on the bank’s books as more fully defined under international accounting standards.

i) **Intangible asset** – means the identifiable non-monetary assets of a bank, which have no physical substance, which are carried and controlled as a result of past events and from which future economic benefits are expected to flow as more fully defined under international accounting standards.

j) **A direct credit substitute** – means any arrangement in which a bank assumes risk of credit-related losses from assets or other claims that it has not transferred, when the risk of credit loss exceeds the banks pro rata share of the assets or other claims of the bank.

k) **Trade-related letters of credit** – means short-term self-liquidating instruments used to finance the movement of goods and are collateralized by the underlying goods.

l) **Operational risk** – means the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. This definition includes legal risk, but excludes strategic and reputation risk.

m) **Loan-to-value ratio (LTV)** – is defined as the outstanding principal balance on the loan amount divided by the current estimated market value of the property.

### Article 3
**Minimum Capital**

1. According to paragraph 1 of Article 15 of the Law on Banks, Microfinance Institutions and Non Bank Financial Institutions, banks should have at all times at least seven (7) million Euros, subject to the restrictions in paragraph 2 of Article 15 of the Law No.04/L-093 on Banks, Microfinance Institutions and Non Bank Financial Institutions.

2. The requirement from the paragraph 1 of this Article must be satisfied within 6 months of entry into force of the Law No.04/L-093 on Banks, Microfinance Institutions and Non Bank Financial Institutions.

### Article 4
**Capital Adequacy Ratio**

1. Banks are required to maintain a minimum ratio of 12% (percent) of total capital and 8% (eight percent) in Tier 1 capital in report to risk weighted assets and other risks. This
minimum applies to all banks. According to its mandate in paragraph 2 of Article 16 of the
Law No.04/L-093 on Banks, Microfinance Institutions and Non Bank Financial
Institutions, the CBK may require from banks to maintain these ratios in higher percentage
than the level defined above.

2. CBK also applies a minimum leverage ratio provided with Article 9 of this Regulation.

Article 5
Risk Weighted Assets and Off-balance Sheet Claims

1. The risk weights of the bank assets with the aim of measuring bank’s compliance with this
Regulation are as follows:

Category 1 - Zero Percent (0%) Risk Weight

a) Cash in Euro and in foreign readily convertible currencies.

b) Balances due from the CBK, and claims on Central Banks of countries rated from the
Rating Agencies, as described in Annex I.

c) Holding of securities issued by the Government and Municipalities of the Republic of
Kosovo.

d) Direct claims from or claims unconditionally guaranteed by central governments of
countries, classified from Rating Agencies, as described in Appendix I.

e) Precious metals and precious stones appraised at values approved by the CBK on a
case by case basis held in a bank’s own vault or if in the vaults of a depository, clearly
appropriated to such bank.

f) Loans or the portions thereof, supported by cash in Euro or other readily convertible
currency, maintained at current value, deposited in the bank, pledged and blocked for
the purpose.

g) Claims for the funds which are fully established by one or more central governments,
central banks, multilateral development banks, or entities of public sector rated
assigned as risk-weighted according to the jurisdiction where established, to which
shall be applied 0% risk weight as per the requirements of this regulation. The only
source of these funds shall be the funds paid from the abovementioned institutions in
form of participation, and not financed through debts.
h) Claims to the IMF– International Monetary Fund, BIS – Bank for International Settlements, European Central Bank and to the European Community, and towards European Community.

g) Claims to the following Multilateral Development Banks: International Bank for Reconstruction and Development; International Finance Corporation; Inter-American Development Bank; Asian Development Bank; African Development Bank; Council of Europe Development Bank; Nordic Investment Bank; Caribbean Development Bank; European Bank for Reconstruction and Development; European Investment Bank; European Investment Fund; Multilateral Investment Guarantee Agency; International Finance Facility for Immunisation; and Islamic Development Bank.

**Category 2 - Twenty percent (20%) Risk Weight**

a) Direct claims from or claims unconditionally guaranteed by banks with short-term credit ratings from the Rating Agencies, as described in **Annex I**.

b) Loans or the portions thereof supported by collateral in the form of securities issued or unconditionally guaranteed by Central Banks or central governments of countries rated the Rating Agencies, as described in **Annex I**.

c) Securities issued by or unconditionally guaranteed by Central Banks or Central Governments of countries rated by the Rating Agencies, as described in Annex I.

d) Loans or the portions thereof supported by collateral, issued by or guaranteed by multilateral lending institutions or global or regional development institutions, subject to the prior approval of the CBK.

e) Claims from banks, with residual maturity of up to one year and claims with residual maturity of up to one year, covered by irrevocable and unconditional guarantees and securities issued by these banks, licensed by CBK. Claims from banks shall not include bank’s claims serving as collateral in other banks, claims included as a component of the own funds of those banks, as well as claims on banks in court procedure.

f) Cash items in process of collections.

**Category 3 - Thirty-five percent (35%) Risk Weight**

(a) Qualifying residential mortgage loans – A Category (QRM-A) according to CBK regulation on residential mortgages.
Category 4 – Fifty percent (50%) Risk Weight

(a) Direct claims with maturity of one year or less or claims unconditionally guaranteed by banks, subject to prior approval of the CBK, that have short-term credit ratings from the Rating Agencies, as described in Annex I.

(b) Direct claims from or claims unconditionally guaranteed by the central governments of states, classified by the Rating Agencies, as described in Annex 1.

(c) Qualified residential mortgage loans – B Category (QRM-B) according to CBK regulation on residential mortgage loans.

Category 5 – Seventy-five Percent (75%) Risk Weight

(a) Loans or the portions thereof covered by collateral in the form of first lien residential mortgages whose underlying indebtedness is not more than 30 days past due (if a loan is more than 30 day past due, than whole exposure of that borrower should be weighted same as the loan with the exception for cash covered loans and if the source of payment for other exposures are different from the one for the loan), subject to the following conditions:

(i) Ownership of residential property must be verified and documented;

(ii) Maximum of loan-to-value (LTV) ratio with the value of immovable property cannot exceed sixty-five (65%) percent; and

(iii) Market value of immovable property must be supported by an independent appraiser, which can be in the form of an appraisal conducted by a qualified and licensed real property appraiser, or the tax base of the real property established by the Municipalities in accordance with Law on the Taxes on Immovable Property in the Republic of Kosovo.

b) Loans to builders to finance real estate construction, where the financed property was sold or leased pursuant to a legally enforceable contract, where from the sales proceeds or rentals the bank profits unconditionally.

Category 6 – One Hundred Percent (100%) Risk Weight

a) Direct claims having maturities of one year or less or claims unconditionally guaranteed by banks, subject to prior approval by the CBK, that are not rated.

b) All other claims of debtors that do not qualify for a Category of risk weight 1-4.
c) Business premises, plants and equipments, other fixed assets and other immobile property as a result of foreclosures or other forms of takings of property, as a result of defaults.

d) Qualifying residential mortgage loans past due more than 90 days net of specific provisioning.

Category 7 – One Hundred and Fifty Percent (150 %) Risk Weight

(a) Direct claims having maturities of one year or less or claims unconditionally guaranteed by banks, subject to prior approval of the CBK, that have short-term credit rating, as described in Annex I.

2. Off-Balance-Sheet items conversion factors

The following values are assigned to off balance-sheet items:

a) Unused portions of commitments with base maturities of 1(one) year or less and unused portions of commitments which are unconditionally cancellable at any time, regardless of maturity, will be assigned 0% of their nominal value for risk weighting purposes.

c) Short-term self-liquidating trade related contingencies; including commercial letters of credit and bid guarantees will be assigned 20% of their nominal values for risk weighting purposes.

c) Direct credit substitutes including guarantees of payment and standby letters of credit will be assigned 100% of their nominal values for risk-weighting purposes.

d) Any other item not included in (b) and (c) will be assigned 100% of their nominal values for conversion to balance-sheet equivalents.

Article 6
Operational Risk

1. Banks shall apply the basic indicator approach (BIA) according to the Basel II capital framework.

a) Pursuant to BIA, a capital charge fifteen percent of (15%) of gross income shall be added to the risk weighted assets of the bank for calculating the risk-asset ratio. Gross income is defined as net interest income plus net non-interest income. It is intended that this measure should:
i. be gross of any provisions (e.g. for unpaid interest);

ii. be gross of operating expenses, including fees paid to outsourcing service providers;

iii. exclude inclusion of profits/losses from the sale of securities which are kept in bank books for non-trading purposes;

iv. exclude extraordinary or irregular items as well as income deriving from insurance.

b) For newly established banks, with less than three years of data, shall use actual gross income earned to date for purposes of achieving the average gross income, while leaving the gross income for any remaining quarters as zero.

2. With prior approval by the CBK, banks may use standardized access to calculate its operational risk capital charges. According to standardized access the capital requirement for operational risk is the average of three years of the risk-weighted relevant indicators calculated each year according to business lines (in accordance with Annex II and Annex III). In each year, a negative capital requirement in one business line, resulting from a negative relevant indicator may be imputed to the whole. However, where the aggregate capital charge across all business lines within a given year is negative, then the input to the average for that year shall be zero. The three-year average is calculated on the basis of the last three years observations at the end of each financial year. When audited figures are not available, banks’ estimates may be used.

**Article 7**

**Market Risk**

If CBK assesses that a bank is highly exposed to the market risk it can require additional capital to the bank.

**Article 8**

**Capital planning**

CBK requires from banks to develop an internal process for capital adequacy planning in relation to their risk profiles, which continuously presents the adequate level of capital, estimated by the bank. The bank’s internal process for planning the capital adequacy will be subject to CBK assessment.
Article 9
Leverage Ratio

1. Article 16.2 of the Law No. 04/L-093 on banks, microfinance institutions and non bank financial institutions, authorizes the CBK to establish a minimum leverage ratio.

2. Banks are required to maintain in minimum seven (7%) percent leverage ratio. (Leverage ratio equals to total equity / total assets).

Article 10
Enforcement, remedial measures and civil penalties

Any violation of provisions of this Regulation shall be subject of remedial measures and penalties, as provided for in Law No. 03/L-209 on Central Bank and Law No. 04/L-093 on banks, microfinance institutions and non bank financial institutions.

Article 11
Abrogation

Upon the entry into force of this Regulation, it shall abrogate the Regulation on Bank Capital Adequacy issued by the CBK Board on 26 April 2013 and Regulation on Bank Capital Adequacy issued on 26 February 2015, and any other provisions that may be in conflict with this Regulation.

Article 12
Annexes

Part of this regulation are Annex I, Annex II and Annex III

Article 13
Entry into Force

This regulation shall enter into force on 01 January 2016.

Chairman of the Board of Central Bank of the Republic of Kosovo

Prof. Dr. Bedri Peci
## Annex I

### Claims from Central Banks and Sovereigns

<table>
<thead>
<tr>
<th>Rating</th>
<th>AAA to AA-</th>
<th>A+ to A-</th>
<th>BBB+ to BBB-</th>
<th>BB+ to B-</th>
<th>Below B-</th>
<th>Unrated</th>
</tr>
</thead>
<tbody>
<tr>
<td>Risk Weight</td>
<td>0%</td>
<td>20%</td>
<td>50%</td>
<td>100%</td>
<td>150%</td>
<td>100%</td>
</tr>
</tbody>
</table>

### Claims from Banks

<table>
<thead>
<tr>
<th>Rating</th>
<th>AAA to AA-</th>
<th>A+ to A-</th>
<th>BBB+ to BBB-</th>
<th>BB+ to B-</th>
<th>Below B-</th>
<th>Unrated</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Risk Weights for Claims with Maturity Longer than Three (3) Months</strong></td>
<td>20%</td>
<td>50%</td>
<td>100%</td>
<td>100%</td>
<td>150%</td>
<td>100%</td>
</tr>
<tr>
<td><strong>Risk Weights for Claims with Maturity Shorter than Three (3) Months</strong></td>
<td>20%</td>
<td>20%</td>
<td>20%</td>
<td>50%</td>
<td>150%</td>
<td>100%</td>
</tr>
</tbody>
</table>

### Interpretation

<table>
<thead>
<tr>
<th>Investment-grade ratings</th>
<th>Moody’s</th>
<th>S&amp;P</th>
<th>Fitch</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Long-term</td>
<td>Short-term</td>
<td>Long-term</td>
</tr>
<tr>
<td>Higher credit quality</td>
<td>Aaa</td>
<td>P-1</td>
<td>Aaa+</td>
</tr>
<tr>
<td>High credit quality</td>
<td>Aa1</td>
<td>Aa2</td>
<td>Aa3</td>
</tr>
<tr>
<td>Strong payment capacity</td>
<td>A1</td>
<td>P-2</td>
<td>A+</td>
</tr>
<tr>
<td></td>
<td>A2</td>
<td></td>
<td>A</td>
</tr>
<tr>
<td>Adequate payment capacity</td>
<td>Baa1</td>
<td>P-3</td>
<td>BBB+</td>
</tr>
<tr>
<td></td>
<td>Baa2</td>
<td></td>
<td>BBB</td>
</tr>
<tr>
<td>Last rating in investment-grade</td>
<td>Baa3</td>
<td></td>
<td>BBB-</td>
</tr>
</tbody>
</table>

### Speculative-grade ratings

<table>
<thead>
<tr>
<th>Speculative</th>
<th>Ba1</th>
<th>Not prime</th>
<th>BB+</th>
<th>BB+</th>
</tr>
</thead>
<tbody>
<tr>
<td>Development of credit risk</td>
<td>Ba2</td>
<td>BB</td>
<td>BB</td>
<td></td>
</tr>
<tr>
<td>Due to economic changes</td>
<td>Ba3</td>
<td>BB-</td>
<td>BB-</td>
<td></td>
</tr>
<tr>
<td>Highly speculative</td>
<td>B1</td>
<td>B+</td>
<td>B+</td>
<td></td>
</tr>
<tr>
<td>Credit risk present,</td>
<td>B2</td>
<td>B</td>
<td>B</td>
<td></td>
</tr>
<tr>
<td>With limited margin safety</td>
<td>B3</td>
<td>B-</td>
<td>B-</td>
<td></td>
</tr>
<tr>
<td>High default risk,</td>
<td>Caa1</td>
<td>CCC+</td>
<td>C</td>
<td>CC+</td>
</tr>
</tbody>
</table>

Capacity depending on sustained, favorable conditions | Caa2 | CCC, CCC-
---|---|---
Default, Although prospect of partial recovery | Caa3 | C, D, C, D

Annex II

**Formula for calculating the operational risk capital charge under Basic indicator approach (BIA) is:**

\[
KBIA = \frac{\sum (GI_1 \ldots n \times \alpha)}{n}
\]

Where

- \( KBIA \) = Capital charge under BIA
- \( GI \) = annual gross income of the banks, when positive, over the preceding three years
- \( n \) = number of the preceding three years when annual gross income is positive
- \( \alpha = 15\% \)

**Formula for calculating the operational risk capital charge under Standardized Access (SA) is:**

\[
KSA = \frac{\sum \text{years 1-3 max}[\sum (GI_{1-8} \times \beta_{1-8}), 0]}{3}
\]

Where:

- \( KSA \) = capital charge under SA
- \( GI_{1-8} \) = annual gross income in a given year for each of the eight business lines
- \( \beta_{1-8} \) = a fixed beta factor (as defined in Annex III).

Annex III

<table>
<thead>
<tr>
<th>Business line</th>
<th>List of activities</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Category</td>
<td>Services/Activities</td>
<td>Percentage</td>
</tr>
<tr>
<td>-------------------------------</td>
<td>-------------------------------------------------------------------------------------</td>
<td>------------</td>
</tr>
</tbody>
</table>
| Corporate finance             | Underwriting of financial instruments and/or placing of financial instruments on a firm commitment basis  
|                               | Services related to underwriting  
|                               | Investment advice  
|                               | Advice to undertakings on capital structure, industrial strategy and related matters and advice and services relating to the mergers and the purchase of undertakings  
|                               | Investment research, financial analysis and other forms of general recommendation relating to transactions in financial instruments | 18%        |
| Trade and sale                | Dealing on own account  
|                               | Money broking  
|                               | Reception and re-submission of orders in relation to one or more financial instruments  
|                               | Execution of orders on behalf of clients  
|                               | Placing of financial instruments without a firm commitment basis  
|                               | Operation of multilateral trading facilities | 18%        |
| Retail brokerage (Activities with individual physical persons or with small and medium sized entities) | Reception and re-submission of orders in relation to one or more financial instruments  
|                               | Execution of orders on behalf of clients  
|                               | Placing of financial instruments without a firm commitment basis | 12%        |
| Commercial banking activities | Acceptance of deposits and other repayable funds  
|                               | Lending  
|                               | Financial leasing  
|                               | Guarantees and commitments | 15%        |
| Retail banking Retail mediation (Activities with individual physical persons or with small and medium sized entities) | Acceptance of deposits and other repayable funds  
|                               | Lending  
|                               | Financial leasing  
<p>|                               | Guarantees and commitments | 12%        |
| Payment and settlement        | Money re-transferring services, Issuing and administering the type of payments | 18%        |</p>
<table>
<thead>
<tr>
<th>Service Type</th>
<th>Description</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agency services</td>
<td>Safekeeping and administration of financial instruments for the account of clients, including custodianship and related services such as cash/collateral management</td>
<td>15%</td>
</tr>
</tbody>
</table>
| Asset management     | Portfolio management  
Undertakings for Collective Investment in Transferable Securities  
Other forms of asset management | 12%        |