Directive 2006/48/EC of the European Parliament and of the council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast) (Text with EEA relevance) (repealed)

ANNEX III

THE TREATMENT OF COUNTERPARTY CREDIT RISK OF DERIVATIVE INSTRUMENTS, REPURCHASE TRANSACTIONS, SECURITIES ORCOMMODITIES LENDING OR BORROWING TRANSACTIONS, LONG SETTLEMENT TRANSACTIONS AND MARGIN LENDING TRANSACTIONS

PART 5

Standardised Method

1.   The Standardised Method (SM) can be used only for OTC derivatives and long settlement transactions. The exposure value shall be calculated separately for each netting set. It shall be determined net of collateral, as follows:

exposure value =

$$\beta^* \max \left(CMV\text{-}CMC; \sum_j \left| \sum_i RPT_{ij} - \sum_l RPC_{lj} \right|^* CCRM_j \right)$$

where:

CMV = current market value of the portfolio of transactions within the netting set with a counterparty gross of collateral, that is, where:

$$CMV = \sum_i CMV_i$$

where:

CMVi = the current market value of transaction i;

CMC = the current market value of the collateral assigned to the netting set, that is, where:

$$CMC = \sum_l CMC_l$$

where

CMCl = the current market value of collateral l;

i = index designating transaction;

l = index designating collateral;

j = index designating hedging set category. These hedging sets correspond to risk factors for which risk positions of opposite sign can be offset to yield a net risk position on which the exposure measure is then based;

RPTij = risk position from transaction i with respect to hedging set j;

RPClj = risk position from collateral l with respect to hedging set j;

CCRMj = CCR Multiplier set out in Table 5 with respect to hedging set j;

β = 1.4.

Collateral received from a counterparty has a positive sign and collateral posted to a counterparty has a negative sign.

Collateral that is recognised for this method is confined to the collateral that is eligible under point 11 of Part 1 of Annex VIII to this Directive and point 9 of Annex II to Directive 2006/49/ EC.

2. When an OTC derivative transaction with a linear risk profile stipulates the exchange of a financial instrument for a payment, the payment Part is referred to as the payment leg. Transactions that stipulate the exchange of payment against payment consist of two payment legs. The payment legs consist of the contractually agreed gross payments, including the notional amount of the transaction. Credit institutions may disregard the interest rate risk from payment legs with a remaining maturity of less than one year for the purposes of the following calculations. Credit institutions may treat transactions that consist of two payment legs that are denominated in the same currency, such as interest rate swaps, as a single aggregate transaction. The treatment for payment legs applies to the aggregate transaction.

3. Transactions with a linear risk profile with equities (including equity indices), gold, other precious metals or other commodities as the underlying financial instruments are mapped to a risk position in the respective equity (or equity index) or commodity (including gold and other precious metals) and an interest rate risk position for the payment leg. If the payment leg is denominated in a foreign currency, it is additionally mapped to a risk position in the respective currency.

4. Transactions with a linear risk profile with a debt instrument as the underlying instrument are mapped to an interest rate risk position for the debt instrument and another interest rate risk position for the payment leg. Transactions with a linear risk profile that stipulate the exchange of payment against payment, including foreign exchange forwards, are mapped to an interest rate risk position for each of the payment legs. If the underlying debt instrument is denominated in a foreign currency, the debt instrument is mapped to a risk position in this currency. If a payment leg is denominated in foreign currency, the payment leg is again mapped to a risk position in this currency. The exposure value assigned to a foreign exchange basis swap transaction is zero.

5. The size of a risk position from a transaction with linear risk profile is the effective notional value (market price multiplied by quantity) of the underlying financial instruments (including commodities) converted to the credit institution's domestic currency, except for debt instruments.

6. For debt instruments and for payment legs, the size of the risk position is the effective notional value of the outstanding gross payments (including the notional amount) converted to the credit institution's domestic currency, multiplied by the modified duration of the debt instrument, or payment leg, respectively.

7. The size of a risk position from a credit default swap is the notional value of the reference debt instrument multiplied by the remaining maturity of the credit default swap.

8. The size of a risk position from an OTC derivative with a non#linear risk profile, including options and swaptions, is equal to the delta equivalent effective notional value of the financial instrument that underlies the transaction, except in the case of an underlying debt instrument.

9. The size of a risk position from an OTC derivative with a non#linear risk profile, including options and swaptions, of which the underlying is a debt instrument or a payment leg, is equal to the delta equivalent effective notional value of the financial instrument or payment leg multiplied by the modified duration of the debt instrument, or payment leg, respectively.

10.   For the determination of risk positions, collateral received from a counterparty is to be treated as a claim on the counterparty under a derivative contract (long position) that is due today, while collateral posted is to be treated like an obligation to the counterparty (short position) that is due today.

11.   Credit institutions may use the following formulae to determine the size and sign of a risk position:

for all instruments other than debt instruments:

effective notional value, or

$$\text{delta equivalent notional value} = p_{ref} \frac{\delta V}{\delta p}$$

where:

P_{ref} = price of the underlying instrument, expressed in the reference currency;

V = value of the financial instrument (in the case of an option this is the option price and in the case of a transaction with a linear risk profile this is the value of the underlying instrument itself);

p = price of the underlying instrument, expressed in the same currency as V;

for debt instruments and the payment legs of all transactions:

effective notional value multiplied by the modified duration, or

delta equivalent in notional value multiplied by the modified duration

$$\frac{\delta V}{\delta r}$$

where:

V = value of the financial instrument (in the case of an option this is the option price and in the case of a transaction with a linear risk profile this is the value of the underlying instrument itself or of the payment leg, respectively);

r = interest rate level.

If V is denominated in a currency other than the reference currency, the derivative must be converted into the reference currency by multiplication with the relevant exchange rate.

12.   The risk positions are to be grouped into hedging sets. For each hedging set, the absolute value amount of the sum of the resulting risk positions is computed. This sum is termed the 'net risk position' and is represented by:

$$\left| \sum_i RPT_{ij} - \sum_l RPC_{lj} \right|$$

in the formulae set out in paragraph 1.

13.   For interest rate risk positions from money deposits received from the counterparty as collateral, from payment legs and from underlying debt instruments, to which according to Table 1 of Annex I to Directive 2006/49/EC a capital charge of 1,6 % or less applies, there are six hedging sets for each currency, as set out in Table 4 below. Hedging sets are defined by a combination of the criteria 'maturity' and 'referenced interest rates'.

Directive 2006/48/EC of the European Parliament and of the council of 14 June...
ANNEX III PART 5
Document Generated: 2023-09-03

5

TABLE 4

	Government referenced interest rates	Non#government referenced interest rates
Maturity Maturity Maturity	← 1 year >1 — ← 5 years > 5 years	← 1 year >1 — ← 5 years > 5 years

14.   For interest rate risk positions from underlying debt instruments or payment legs for which the interest rate is linked to a reference interest rate that represents a general market interest level, the remaining maturity is the length of the time interval up to the next re#adjustment of the interest rate. In all other cases, it is the remaining life of the underlying debt instrument or in the case of a payment leg, the remaining life of the transaction.

15.   There is one hedging set for each issuer of a reference debt instrument that underlies a credit default swap.

16.   For interest rate risk positions from money deposits that are posted with a counterparty as collateral when that counterparty does not have debt obligations of low specific risk outstanding and from underlying debt instruments, to which according to Table 1 of Annex I to Directive 2006/49/EC a capital charge of more than 1,6 % applies, there is one hedging set for each issuer. When a payment leg emulates such a debt instrument, there is also one hedging set for each issuer of the reference debt instrument. Credit institutions may assign risk positions that arise from debt instruments of a certain issuer, or from reference debt instruments of the same issuer that are emulated by payment legs, or that underlie a credit default swap, to the same hedging set.

17.   Underlying financial instruments other than debt instruments shall be assigned to the same respective hedging sets only if they are identical or similar instruments. In all other cases they shall be assigned to separate hedging sets. The similarity of instruments is established as follows:

—   for equities, similar instruments are those of the same issuer. An equity index is treated as a separate issuer;

—   for precious metals, similar instruments are those of the same metal. A precious metal index is treated as a separate precious metal;

—   for electric power, similar instruments are those delivery rights and obligations that refer to the same peak or off#peak load time interval within any 24#hour interval; and

—   for commodities, similar instruments are those of the same commodity. A commodity index is treated as a separate commodity.

18.   The CCR multipliers (CCRM) for the different hedging set categories are set out in Table 5 below:

TABLE 5

	Hedging set categories	CCRM
1.	Interest Rates	0,2 %
2.	Interest Rates for risk positions from a reference	0,3 %

	debt instrument that underlies a credit default swap and to which a capital charge of 1,6 %, or less, applies under Table 1 of Annex I to Directive 2006/49/EC	
3.	Interest Rates for risk positions from a debt instrument or reference debt instrument to which a capital charge of more than 1,6 % applies under Table 1 of Annex I to Directive 2006/49/EC	0,6 %
4.	Exchange Rates	2,5 %
5.	Electric Power	4 %
6.	Gold	5 %
7..	Equity	7 %
8.	Precious Metals (except gold)	8,5 %
9.	Other Commodities (excluding precious metals and electricity power)	10 %
10.	Underlying instruments of OTC derivatives that are not in any of the above categories	10 %

Underlying instruments of OTC derivatives, as referred to in point 10 of Table 5, shall be assigned to separate individual hedging sets for each category of underlying instrument.

19.   For transactions with a non#linear risk profile or for payment legs and transactions with debt instruments as underlying for which the credit institution cannot determine the delta or the modified duration, respectively, with an instrument model that the competent authority has approved for the purposes of determining the minimum capital requirements for market risk, the competent authority shall determine the size of the risk positions and the applicable CCRMjs conservatively. Alternatively, competent authorities may require the use of the method set out in Part 3. Netting shall not be recognised (that is, the exposure value shall be determined as if there were a netting set that comprises just the individual transaction).

20.   A credit institution shall have internal procedures to verify that, prior to including a transaction in a hedging set, the transaction is covered by a legally enforceable netting contract that meets the requirements set out in Part 7.

21.   A credit institution that makes use of collateral to mitigate its CCR shall have internal procedures to verify that, prior to recognising the effect of collateral in its calculations, the collateral meets the legal certainty standards set out in Annex VIII.