

## ANNEX I

## CALCULATING CAPITAL REQUIREMENTS FOR POSITION RISK

## GENERAL PROVISIONS

## Netting

1. The excess of an institution's long (short) positions over its short (long) positions in the same equity, debt and convertible issues and identical financial futures, options, warrants and covered warrants shall be its net position in each of those different instruments. In calculating the net position the competent authorities shall allow positions in derivative instruments to be treated, as laid down in points 4 to 7, as positions in the underlying (or notional) security or securities. Institutions' holdings of their own debt instruments shall be disregarded in calculating specific risk under point 14.
2. No netting shall be allowed between a convertible and an offsetting position in the instrument underlying it, unless the competent authorities adopt an approach under which the likelihood of a particular convertible's being converted is taken into account or have a capital requirement to cover any loss which conversion might entail.
3. All net positions, irrespective of their signs, must be converted on a daily basis into the institution's reporting currency at the prevailing spot exchange rate before their aggregation.

Particular4. Interest#rate futures, forward#rate agreements (FRAs) and forward commitments instruments buy or sell debt instruments shall be treated as combinations of long and short positions. Thus a long interest#rate futures position shall be treated as a combination of a borrowing maturing on the delivery date of the futures contract and a holding of an asset with maturity date equal to that of the instrument or notional position underlying the futures contract in question. Similarly a sold FRA will be treated as a long position with a maturity date equal to the settlement date plus the contract period, and a short position with maturity equal to the settlement date. Both the borrowing and the asset holding shall be included in the first category set out in Table 1 in point 14 in order to calculate the capital required against specific risk for interest#rate futures and FRAs. A forward commitment to buy a debt instrument shall be treated as a combination of a borrowing maturing on the delivery date and a long (spot) position in the debt instrument itself. The borrowing shall be included in the first category set out in Table 1 in point 14 for purposes of specific risk, and the debt instrument under whichever column is appropriate for it in the same table.

The competent authorities may allow the capital requirement for an exchange#traded future to be equal to the margin required by the exchange if they are fully satisfied that it provides an accurate measure of the risk associated with the future and that it is at least equal to the capital requirement for a future that would result from a calculation made using the method set out in this Annex or applying the internal models method described in Annex V. The competent authorities may also allow the capital requirement for an OTC derivatives contract of the type referred to in this point cleared by a clearing house recognised by them to be equal to the margin required by the clearing house if they are fully satisfied that it provides an accurate measure of the risk associated with the derivatives contract and that it is at least equal to the capital requirement for the contract in question that would result from a calculation made using the method set out in the this Annex or applying the internal models method described in Annex V.

For the purposes of this point, ‘long position’ means a position in which an institution has fixed the interest rate it will receive at some time in the future, and ‘short position’ means a position in which it has fixed the interest rate it will pay at some time in the future.

5. Options on interest rates, debt instruments, equities, equity indices, financial futures, swaps and foreign currencies shall be treated as if they were positions equal in value to the amount of the underlying instrument to which the option refers, multiplied by its delta for the purposes of this Annex. The latter positions may be netted off against any offsetting positions in the identical underlying securities or derivatives. The delta used shall be that of the exchange concerned, that calculated by the competent authorities or, where that is not available or for OTC-options, that calculated by the institution itself, subject to the competent authorities being satisfied that the model used by the institution is reasonable.

However, the competent authorities may also prescribe that institutions calculate their deltas using a methodology specified by the competent authorities.

Other risks, apart from the delta risk, associated with options shall be safeguarded against. The competent authorities may allow the requirement against a written exchange-traded option to be equal to the margin required by the exchange if they are fully satisfied that it provides an accurate measure of the risk associated with the option and that it is at least equal to the capital requirement against an option that would result from a calculation made using the method set out in the remainder of this Annex or applying the internal models method described in Annex V. The competent authorities may also allow the capital requirement for an OTC option cleared by a clearing house recognised by them to be equal to the margin required by the clearing house if they are fully satisfied that it provides an accurate measure of the risk associated with the option and that it is at least equal to the capital requirement for an OTC option that would result from a calculation made using the method set out in the remainder of this Annex or applying the internal models method described in Annex V. In addition they may allow the requirement on a bought exchange-traded or OTC option to be the same as that for the instrument underlying it, subject to the constraint that the resulting requirement does not exceed the market value of the option. The requirement against a written OTC option shall be set in relation to the instrument underlying it.

6. Warrants relating to debt instruments and equities shall be treated in the same way as options under point 5.
7. Swaps shall be treated for interest-rate risk purposes on the same basis as on-balance-sheet instruments. Thus, an interest-rate swap under which an institution receives floating-rate interest and pays fixed-rate interest shall be treated as equivalent to a long position in a floating-rate instrument of maturity equivalent to the period until the next interest fixing and a short position in a fixed-rate instrument with the same maturity as the swap itself.