ANNEX I

CALCULATING CAPITAL REQUIREMENTS FOR POSITION RISK

SPECIFIC RISK CAPITAL CHARGES FOR TRADING BOOK POSITIONS HEDGED BY CREDIT DERIVATIVES

42. An allowance shall be given for protection provided by credit derivatives, in accordance with the principles set out in points 43 to 46.

43. Full allowance shall be given when the value of two legs always move in the opposite direction and broadly to the same extent. This will be the case in the following situations:

(a) the two legs consist of completely identical instruments; or

(b) a long cash position is hedged by a total rate of return swap (or vice versa) and there is an exact match between the reference obligation and the underlying exposure (i.e., the cash position). The maturity of the swap itself may be different from that of the underlying exposure.

In these situations, a specific risk capital charge should not be applied to either side of the position.

44. An 80 % offset will be applied when the value of two legs always move in the opposite direction and where there is an exact match in terms of the reference obligation, the maturity of both the reference obligation and the credit derivative, and the currency of the underlying exposure. In addition, key features of the credit derivative contract should not cause the price movement of the credit derivative to materially deviate from the price movements of the cash position. To the extent that the transaction transfers risk, an 80 % specific risk offset will be applied to the side of the transaction with the higher capital charge, while the specific risk requirements on the other side shall be zero.

45. Partial allowance shall be given when the value of two legs usually move in the opposite direction. This would be the case in the following situations:

(a) the position falls under point 43(b) but there is an asset mismatch between the reference obligation and the underlying exposure. However, the positions meet the following requirements:

  (i) the reference obligation ranks pari passu with or is junior to the underlying obligation; and

  (ii) the underlying obligation and reference obligation share the same obligor and have legally enforceable cross#default or cross#acceleration clauses;

(b) the position falls under point 43(a) or point 44 but there is a currency or maturity mismatch between the credit protection and the underlying asset (currency mismatches should be included in the normal reporting foreign exchange risk under Annex III); or

(c) the position falls under point 44 but there is an asset mismatch between the cash position and the credit derivative. However, the underlying asset is included in the (deliverable) obligations in the credit derivative documentation.

In each of those situations, rather than adding the specific risk capital requirements for each side of the transaction, only the higher of the two capital requirements shall apply.

46. In all situations not falling under points 43 to 45, a specific risk capital charge will be assessed against both sides of the positions.

Capital charges for CIUs in the trading book

47. The capital requirements for positions in CIUs which meet the conditions specified in Article 11 for a trading book capital treatment shall be calculated in accordance with the methods set out in points 48 to 56.

48. Without prejudice to other provisions in this section, positions in CIUs shall be subject to a capital requirement for position risk (specific and general) of 32 %. Without prejudice to the provisions of the fourth paragraph of point 2.1 of Annex III or the sixth paragraph of point 12 of Annex V (commodity risk) taken together with the fourth paragraph of point 2.1 of Annex III, where the modified gold treatment set out in those points is used, positions in CIUs shall be subject to a capital requirement for position risk (specific and general) and foreign-exchange risk of no more than 40 %.

49. Institutions may determine the capital requirement for positions in CIUs which meet the criteria set out in point 51, by the methods set out in points 53 to 56.

50. Unless noted otherwise, no netting is permitted between the underlying investments of a CIU and other positions held by the institution.