

ANNEX I

CALCULATING CAPITAL REQUIREMENTS FOR POSITION RISK

A.TREATMENT OF THE PROTECTION SELLER

8. When calculating the capital requirement for market risk of the party who assumes the credit risk (the ‘protection seller’), unless specified differently, the notional amount of the credit derivative contract must be used. For the purpose of calculating the specific risk charge, other than for total return swaps, the maturity of the credit derivative contract is applicable instead of the maturity of the obligation. Positions are determined as follows:
- (i) A total return swap creates a long position in the general market risk of the reference obligation and a short position in the general market risk of a government bond with a maturity equivalent to the period until the next interest fixing and which is assigned a 0 % risk weight under Annex VI of Directive 2006/48/EC. It also creates a long position in the specific risk of the reference obligation.
 - (ii) A credit default swap does not create a position for general market risk. For the purposes of specific risk, the institution must record a synthetic long position in an obligation of the reference entity, unless the derivative is rated externally and meets the conditions for a qualifying debt item, in which case a long position in the derivative is recorded. If premium or interest payments are due under the product, these cash flows must be represented as notional positions in government bonds.
 - (iii) A single name credit linked note creates a long position in the general market risk of the note itself, as an interest rate product. For the purpose of specific risk, a synthetic long position is created in an obligation of the reference entity. An additional long position is created in the issuer of the note. Where the credit linked note has an external rating and meets the conditions for a qualifying debt item, a single long position with the specific risk of the note need only be recorded.
 - (iv) In addition to a long position in the specific risk of the issuer of the note, a multiple name credit linked note providing proportional protection creates a position in each reference entity, with the total notional amount of the contract assigned across the positions according to the proportion of the total notional amount that each exposure to a reference entity represents. Where more than one obligation of a reference entity can be selected, the obligation with the highest risk weighting determines the specific risk.

Where a multiple name credit linked note has an external rating and meets the conditions for a qualifying debt item, a single long position with the specific risk of the note need only be recorded.
 - (v) A first-asset-to-default credit derivative creates a position for the notional amount in an obligation of each reference entity. If the size of the maximum credit event payment is lower than the capital requirement under the method in the first sentence of this point, the maximum payment amount may be taken as the capital requirement for specific risk.

A second-asset-to-default credit derivative creates a position for the notional amount in an obligation of each reference entity less one (that with the lowest specific risk capital requirement). If the size of the maximum credit event payment is lower than the capital requirement under the method in the first sentence of this point, this amount may be taken as the capital requirement for specific risk.

Status: This is the original version (as it was originally adopted).

If a first or second-asset to default derivative is externally rated and meets the conditions for a qualifying debt item, then the protection seller need only calculate one specific risk charge reflecting the rating of the derivative.