

Directive 2006/49/EC of the European Parliament and of the Council of 14 June 2006 on the capital adequacy of investment firms and credit institutions (recast) (repealed)

Status: EU Directives are being published on this site to aid cross referencing from UK legislation. After IP completion day (31 December 2020 11pm) no further amendments will be applied to this version.

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.

Particular 4. 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.

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:

Status: EU Directives are being published on this site to aid cross referencing from UK legislation. After IP completion day (31 December 2020 11pm) no further amendments will be applied to this version.

- (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.

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.

B. TREATMENT OF THE PROTECTION BUYER

For the party who transfers credit risk (the ‘protection buyer’), the positions are determined as the mirror image of the protection seller, with the exception of a credit linked note (which entails no short position in the issuer). If at a given moment there is a call option in combination with a step#up, such moment is treated as the maturity of the protection. In the case of nth to default credit derivatives, protection buyers are allowed to off#set specific risk for n-1 of the underlyings (i.e., the n-1 assets with the lowest specific risk charge).

9. Institutions which mark to market and manage the interest#rate risk on the derivative instruments covered in points 4 to 7 on a discounted#cash#flow basis may use sensitivity models to calculate the positions referred to in those points and may use them for any bond which is amortised over its residual life rather than via one final repayment of principal. Both the model and its use by the institution must be approved by the competent authorities. These models should generate positions which have the same sensitivity to interest#rate changes as the underlying cash flows. This sensitivity must be assessed with reference to independent movements in sample rates across the yield curve, with at least one sensitivity point in each of the maturity bands set out in Table 2 of point 20. The positions shall be included in the calculation of capital requirements according to the provisions laid down in points 17 to 32.
10. Institutions which do not use models under point 9 may, with the approval of the competent authorities, treat as fully offsetting any positions in derivative instruments covered in points 4 to 7 which meet the following conditions at least:
- (a) the positions are of the same value and denominated in the same currency;
 - (b) the reference rate (for floating#rate positions) or coupon (for fixed#rate positions) is closely matched; and
 - (c) the next interest#fixing date or, for fixed coupon positions, residual maturity corresponds with the following limits:
 - (i) less than one month hence: same day;
 - (ii) between one month and one year hence: within seven days; and
 - (iii) over one year hence: within 30 days.
11. The transferor of securities or guaranteed rights relating to title to securities in a repurchase agreement and the lender of securities in a securities lending shall include these securities in the calculation of its capital requirement under this Annex provided that such securities meet the criteria laid down in Article 11.

Specific and general risks

12. The position risk on a traded debt instrument or equity (or debt or equity derivative) shall be divided into two components in order to calculate the capital required against it. The first shall be its specific#risk component — this is the risk of a price change in the instrument concerned due to factors related to its issuer or, in the case of a derivative, the issuer of the underlying instrument. The second component shall cover its general risk — this is the risk of a price change in the instrument due (in the case of a traded debt instrument or debt derivative) to a change in the level of interest rates or (in the case of an equity or equity derivative) to a broad equity#market movement unrelated to any specific attributes of individual securities.

TRADED DEBT INSTRUMENTS

13. Net positions shall be classified according to the currency in which they are denominated and shall calculate the capital requirement for general and specific risk in each individual currency separately.

Specific risk

14. The institution shall assign its net positions in the trading book, as calculated in accordance with point 1 to the appropriate categories in Table 1 on the basis of their issuer/obligor, external or internal credit assessment, and residual maturity, and then multiply them by the weightings shown in that table. It shall sum its weighted

Status: EU Directives are being published on this site to aid cross referencing from UK legislation. After IP completion day (31 December 2020 11pm) no further amendments will be applied to this version.

positions (regardless of whether they are long or short) in order to calculate its capital requirement against specific risk.

TABLE 1

Categories	Specific risk capital charge
Debt securities issued or guaranteed by central governments, issued by central banks, international organisations, multilateral development banks or Member States' regional government or local authorities which would qualify for credit quality step 1 or which would receive a 0 % risk weight under the rules for the risk weighting of exposures under Articles 78 to 83 of Directive 2006/48/EC.	0 %
Debt securities issued or guaranteed by central governments, issued by central banks, international organisations, multilateral development banks or Member States' regional governments or local authorities which would qualify for credit quality step 2 or 3 under the rules for the risk weighting of exposures under Articles 78 to 83 of Directive 2006/48/EC, and debt securities issued or guaranteed by institutions which would qualify for credit quality step 1 or 2 under the rules for the risk weighting of exposures under Articles 78 to 83 of Directive 2006/48/EC, and debt securities issued or guaranteed by institutions which would qualify for credit quality step 3 under the rules for the risk weighting of exposures under point 28, Part 1 of Annex VI to Directive 2006/48/EC, and debt securities issued or guaranteed by corporates which would qualify for credit quality step 1 or 2 under the rules for the risk weighting of exposures under Articles 78 to 83 of Directive 2006/48/EC. Other qualifying items as defined in point 15.	0,25 % (residual term to final maturity 6 months or less) 1,0 % (residual term to final maturity greater than 6 and up to and including 24 months) 1,6 % (residual term to final maturity exceeding 24 months)
Debt securities issued or guaranteed by central governments, issued by central banks, international organisations, multilateral development banks or Member States' regional governments	8,0 %

Status: EU Directives are being published on this site to aid cross referencing from UK legislation. After IP completion day (31 December 2020 11pm) no further amendments will be applied to this version.

<p>or local authorities or institutions which would qualify for credit quality step 4 or 5 under the rules for the risk weighting of exposures under Articles 78 to 83 of Directive 2006/48/EC, and debt securities issued or guaranteed by institutions which would qualify for credit quality step 3 under the rules for the risk weighting of exposures under point 26 of Part 1 of Annex VI to Directive 2006/48/EC, and debt securities issued or guaranteed by corporates which would qualify for credit quality step 3 or 4 under the rules for the risk weighting of exposures under Articles 78 to 83 of Directive 2006/48/EC. Exposures for which a credit assessment by a nominated ECAI is not available.</p>	
<p>Debt securities issued or guaranteed by central governments, issued by central banks, international organisations, multilateral development banks or Member States' regional governments or local authorities or institutions which would qualify for credit quality step 6 under the rules for the risk weighting of exposures under Articles 78 to 83 of Directive 2006/48/EC, and debt securities issued or guaranteed by corporates which would qualify for credit quality step 5 or 6 under the rules for the risk weighting of exposures under Articles 78 to 83 of Directive 2006/48/EC.</p>	12,0 %

For institutions which apply the rules for the risk weighting of exposures under Articles 84 to 89 of Directive 2006/48/EC, to qualify for a credit quality step the obligor of the exposure shall have an internal rating with a PD equivalent to or lower than that associated with the appropriate credit quality step under the rules for the risk weighting of exposures to corporates under Articles 78 to 83 of that Directive.

Instruments issued by a non-qualifying issuer shall receive a specific risk capital charge of 8 % or 12 % according to Table 1. Competent authorities may require institutions to apply a higher specific risk charge to such instruments and/or to disallow offsetting for the purposes of defining the extent of general market risk between such instruments and any other debt instruments.

Securitisation exposures that would be subject to a deduction treatment as set out in Article 66(2) of Directive 2006/48/EC, or risk-weighted at 1,25 % as set out in Part 4 of Annex IX to that Directive, shall be subject to a capital charge that is no less than that set out under those treatments. Unrated liquidity facilities shall be subject to a capital charge that is no less than that set out in Part 4 of Annex IX to Directive 2006/48/EC.

Status: EU Directives are being published on this site to aid cross referencing from UK legislation. After IP completion day (31 December 2020 11pm) no further amendments will be applied to this version.

15. For the purposes of point 14 qualifying items shall include:
- (a) long and short positions in assets qualifying for a credit quality step corresponding at least to investment grade in the mapping process described in Title V, Chapter 2, Section 3, Sub#section 1 of Directive 2006/48/EC;
 - (b) long and short positions in assets which, because of the solvency of the issuer, have a PD which is not higher than that of the assets referred to under (a), under the approach described in Title V, Chapter 2, Section 3, Sub#section 2 of Directive 2006/48/EC;
 - (c) long and short positions in assets for which a credit assessment by a nominated external credit assessment institution is not available and which meet the following conditions:
 - (i) they are considered by the institutions concerned to be sufficiently liquid;
 - (ii) their investment quality is, according to the institution's own discretion, at least equivalent to that of the assets referred to under point (a); and
 - (iii) they are listed on at least one regulated market in a Member State or on a stock exchange in a third country provided that the exchange is recognised by the competent authorities of the relevant Member State;
 - (d) long and short positions in assets issued by institutions subject to the capital adequacy requirements set out in Directive 2006/48/EC which are considered by the institutions concerned to be sufficiently liquid and whose investment quality is, according to the institution's own discretion, at least equivalent to that of the assets referred to under point (a); and
 - (e) securities issued by institutions that are deemed to be of equivalent, or higher, credit quality than those associated with credit quality step 2 under the rules for the risk weighting of exposures to institutions set out in Articles 78 to 83 of Directive 2006/48/EC and that are subject to supervisory and regulatory arrangements comparable to those under this Directive.

The manner in which the debt instruments are assessed shall be subject to scrutiny by the competent authorities, which shall overturn the judgment of the institution if they consider that the instruments concerned are subject to too high a degree of specific risk to be qualifying items.

16. The competent authorities shall require the institution to apply the maximum weighting shown in Table 1 to point 14 to instruments that show a particular risk because of the insufficient solvency of the issuer.

General risk

- (a) Maturity-based
17. The procedure for calculating capital requirements against general risk involves two basic steps. First, all positions shall be weighted according to maturity (as explained in point 18), in order to compute the amount of capital required against them. Second, allowance shall be made for this requirement to be reduced when a weighted position is held alongside an opposite weighted position within the same maturity band. A reduction in the requirement shall also be allowed when the opposite weighted positions fall into different maturity bands, with the size of this reduction depending both on whether the two positions fall into the same zone, or not, and on the particular zones they fall into. There are three zones (groups of maturity bands) altogether.

18. The institution shall assign its net positions to the appropriate maturity bands in column 2 or 3, as appropriate, in Table 2 in point 20. It shall do so on the basis of residual maturity in the case of fixed-rate instruments and on the basis of the period until the interest rate is next set in the case of instruments on which the interest rate is variable before final maturity. It shall also distinguish between debt instruments with a coupon of 3 % or more and those with a coupon of less than 3 % and thus allocate them to column 2 or column 3 in Table 2. It shall then multiply each of them by the weighing for the maturity band in question in column 4 in Table 2.
19. It shall then work out the sum of the weighted long positions and the sum of the weighted short positions in each maturity band. The amount of the former which are matched by the latter in a given maturity band shall be the matched weighted position in that band, while the residual long or short position shall be the unmatched weighted position for the same band. The total of the matched weighted positions in all bands shall then be calculated.
20. The institution shall compute the totals of the unmatched weighted long positions for the bands included in each of the zones in Table 2 in order to derive the unmatched weighted long position for each zone. Similarly, the sum of the unmatched weighted short positions for each band in a particular zone shall be summed to compute the unmatched weighted short position for that zone. That part of the unmatched weighted long position for a given zone that is matched by the unmatched weighted short position for the same zone shall be the matched weighted position for that zone. That part of the unmatched weighted long or unmatched weighted short position for a zone that cannot be thus matched shall be the unmatched weighted position for that zone.

TABLE 2

Zone	Maturity band		Weighting (in %)	Assumed interest rate change (in %)
	Coupon of 3 % or more	Coupon of less than 3 %		
One	0 ≤ 1 month	0 ≤ 1 month	0,0	—
	> 1 ≤ 3 months	> 1 ≤ 3 months	0,2	1,0
	> 3 ≤ 6 months	> 3 ≤ 6 months	0,4	1,0
	> 6 ≤ 12 months	> 6 ≤ 12 months	0,7	1,0
Two	> 1 ≤ 2 years	> 1,0 ≤ 1,9 years	1,25	0,9
	> 2 ≤ 3 years	> 1,9 ≤ 2,8 years	1,75	0,8
	> 3 ≤ 4 years	> 2,8 ≤ 3,6 years	2,25	0,75
Three	> 4 ≤ 5 years	> 3,6 ≤ 4,3 years	2,75	0,75
	> 5 ≤ 7 years	> 4,3 ≤ 5,7 years	3,25	0,7

Status: EU Directives are being published on this site to aid cross referencing from UK legislation. After IP completion day (31 December 2020 11pm) no further amendments will be applied to this version.

> 7 ≤ 10 years	> 5,7 ≤ 7,3 years	3,75	0,65
> 10 ≤ 15 years	> 7,3 ≤ 9,3 years	4,5	0,6
> 15 ≤ 20 years	> 9,3 ≤ 10,6 years	5,25	0,6
> 20 years	> 10,6 ≤ 12,0 years	6,0	0,6
	> 12,0 ≤ 20,0 years	8,0	0,6
	> 20 years	12,5	0,6

21. The amount of the unmatched weighted long (short) position in zone one which is matched by the unmatched weighted short (long) position in zone two shall then be computed. This shall be referred to in point 25 as the matched weighted position between zones one and two. The same calculation shall then be undertaken with regard to that part of the unmatched weighted position in zone two which is left over and the unmatched weighted position in zone three in order to calculate the matched weighted position between zones two and three.
22. The institution may, if it wishes, reverse the order in point 21 so as to calculate the matched weighted position between zones two and three before calculating that position between zones one and two.
23. The remainder of the unmatched weighted position in zone one shall then be matched with what remains of that for zone three after the latter's matching with zone two in order to derive the matched weighted position between zones one and three.
24. Residual positions, following the three separate matching calculations in points 21, 22 and 23, shall be summed.
25. The institution's capital requirement shall be calculated as the sum of:
- (a) 10 % of the sum of the matched weighted positions in all maturity bands;
 - (b) 40 % of the matched weighted position in zone one;
 - (c) 30 % of the matched weighted position in zone two;
 - (d) 30 % of the matched weighted position in zone three;
 - (e) 40 % of the matched weighted position between zones one and two and between zones two and three (see point 21);
 - (f) 150 % of the matched weighted position between zones one and three; and
 - (g) 100 % of the residual unmatched weighted positions.
- (b) Duration-based
26. The competent authorities may allow institutions in general or on an individual basis to use a system for calculating the capital requirement for the general risk on traded debt instruments which reflects duration, instead of the system set out in points 17 to 25, provided that the institution does so on a consistent basis.

27. Under a system referred to in point 26 the institution shall take the market value of each fixed-rate debt instrument and thence calculate its yield to maturity, which is implied discount rate for that instrument. In the case of floating-rate instruments, the institution shall take the market value of each instrument and thence calculate its yield on the assumption that the principal is due when the interest rate can next be changed.

28. The institution shall then calculate the modified duration of each debt instrument on the basis of the following formula: modified duration = ((duration (D))/(1 + r)), where:

$$D = \left(\frac{\sum_{t=1}^M (t C_t) / ((1+r)^t)}{\sum_{t=1}^M (C_t) / ((1+r)^t)} \right)$$

where:

R = yield to maturity (see point 25),

C_t = cash payment in time t,

M = total maturity (see point 25).

29. The institution shall then allocate each debt instrument to the appropriate zone in Table 3. It shall do so on the basis of the modified duration of each instrument.

TABLE 3

Zone	Modified duration(in years)	Assumed interest (change in %)
One	> 0 ≤ 1,0	1,0
Two	> 1,0 ≤ 3,6	0,85
Three	> 3,6	0,7

30. The institution shall then calculate the duration-weighted position for each instrument by multiplying its market price by its modified duration and by the assumed interest-rate change for an instrument with that particular modified duration (see column 3 in Table 3).

31. The institution shall calculate its duration-weighted long and its duration-weighted short positions within each zone. The amount of the former which are matched by the latter within each zone shall be the matched duration-weighted position for that zone.

The institution shall then calculate the unmatched duration-weighted positions for each zone. It shall then follow the procedures laid down for unmatched weighted positions in points 21 to 24.

32. The institution's capital requirement shall then be calculated as the sum of:

- (a) 2 % of the matched duration-weighted position for each zone;
- (b) 40 % of the matched duration-weighted positions between zones one and two and between zones two and three;
- (c) 150 % of the matched duration-weighted position between zones one and three; and
- (d) 100 % of the residual unmatched duration-weighted positions.

EQUITIES

Status: EU Directives are being published on this site to aid cross referencing from UK legislation. After IP completion day (31 December 2020 11pm) no further amendments will be applied to this version.

33. The institution shall sum all its net long positions and all its net short positions in accordance with point 1. The sum of the two figures shall be its overall gross position. The difference between them shall be its overall net position.

Specific risk

34. The institution shall sum all its net long positions and all its net short positions in accordance with point 1. It shall multiply its overall gross position by 4 % in order to calculate its capital requirement against specific risk.
35. By derogation from point 34, the competent authorities may allow the capital requirement against specific risk to be 2 % rather than 4 % for those portfolios of equities that an institution holds which meet the following conditions:
- (a) the equities shall not be those of issuers which have issued only traded debt instruments that currently attract an 8 % or 12 % requirement in Table 1 to point 14 or that attract a lower requirement only because they are guaranteed or secured;
 - (b) the equities must be adjudged highly liquid by the competent authorities according to objective criteria; and
 - (c) no individual position shall comprise more than 5 % of the value of the institution's whole equity portfolio.

For the purpose of point (c), the competent authorities may authorise individual positions of up to 10 % provided that the total of such positions does not exceed 50 % of the portfolio.

General risk

36. Its capital requirement against general risk shall be its overall net position multiplied by 8 %.

Stock-index futures

37. Stock-index futures, the delta-weighted equivalents of options in stock-index futures and stock indices collectively referred to hereafter as 'stock-index futures', may be broken down into positions in each of their constituent equities. These positions may be treated as underlying positions in the equities in question, and may, subject to the approval of the competent authorities, be netted against opposite positions in the underlying equities themselves.
38. The competent authorities shall ensure that any institution which has netted off its positions in one or more of the equities constituting a stock-index future against one or more positions in the stock-index future itself has adequate capital to cover the risk of loss caused by the future's values not moving fully in line with that of its constituent equities; they shall also do this when an institution holds opposite positions in stock-index futures which are not identical in respect of either their maturity or their composition or both.
39. By derogation from points 37 and 38, stock-index futures which are exchange traded and — in the opinion of the competent authorities — represent broadly diversified indices shall attract a capital requirement against general risk of 8 %, but no capital requirement against specific risk. Such stock-index futures shall be included in the calculation of the overall net position in point 33, but disregarded in the calculation of the overall gross position in the same point.
40. If a stock-index future is not broken down into its underlying positions, it shall be treated as if it were an individual equity. However, the specific risk on this individual

equity can be ignored if the stock-index future in question is exchange traded and, in the opinion of the competent authorities, represents a broadly diversified index.

UNDERWRITING

41. In the case of the underwriting of debt and equity instruments, the competent authorities may allow an institution to use the following procedure in calculating its capital requirements. Firstly, it shall calculate the net positions by deducting the underwriting positions which are subscribed or sub#underwritten by third parties on the basis of formal agreements. Secondly, it shall reduce the net positions by the reduction factors in Table 4

TABLE 4

working day 0:	100 %
working day 1:	90 %
working days 2 to 3:	75 %
working day 4:	50 %
working day 5:	25 %
after working day 5:	0 %.

‘Working day zero’ shall be the working day on which the institution becomes unconditionally committed to accepting a known quantity of securities at an agreed price.

Thirdly, it shall calculate its capital requirements using the reduced underwriting positions.

The competent authorities shall ensure that the institution holds sufficient capital against the risk of loss which exists between the time of the initial commitment and working day 1.

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:
- the two legs consist of completely identical instruments; or
 - 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

Status: EU Directives are being published on this site to aid cross referencing from UK legislation. After IP completion day (31 December 2020 11pm) no further amendments will be applied to this version.

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.

GENERAL CRITERIA

51. The general eligibility criteria for using the methods in points 53 to 56, for CIUs issued by companies supervised or incorporated within the Community are that:
- (a) the CIU's prospectus or equivalent document shall include:
 - (i) the categories of assets the CIU is authorised to invest in;

- (ii) if investment limits apply, the relative limits and the methodologies to calculate them;
 - (iii) if leverage is allowed, the maximum level of leverage; and
 - (iv) if investment in OTC financial derivatives or repo-style transactions are allowed, a policy to limit counterparty risk arising from these transactions;
- (b) the business of the CIU shall be reported in half-yearly and annual reports to enable an assessment to be made of the assets and liabilities, income and operations over the reporting period;
- (c) the units/shares of the CIU are redeemable in cash, out of the undertaking's assets, on a daily basis at the request of the unit holder;
- (d) investments in the CIU shall be segregated from the assets of the CIU manager; and
- (e) there shall be adequate risk assessment of the CIU, by the investing institution.
52. Third country CIUs may be eligible if the requirements in points (a) to (e) of point 51 are met, subject to the approval of the institution's competent authority.

SPECIFIC METHODS

53. Where the institution is aware of the underlying investments of the CIU on a daily basis, the institution may look through to those underlying investments in order to calculate the capital requirements for position risk (general and specific) for those positions in accordance with the methods set out in this Annex or, if permission has been granted, in accordance with the methods set out in Annex V. Under this approach, positions in CIUs shall be treated as positions in the underlying investments of the CIU. Netting is permitted between positions in the underlying investments of the CIU and other positions held by the institution, as long as the institution holds a sufficient quantity of units to allow for redemption/creation in exchange for the underlying investments.
54. Institutions may calculate the capital requirements for position risk (general and specific) for positions in CIUs in accordance with the methods set out in this Annex or, if permission has been granted, in accordance with the methods set out in Annex V, to assumed positions representing those necessary to replicate the composition and performance of the externally generated index or fixed basket of equities or debt securities referred to in (a), subject to the following conditions:
- (a) the purpose of the CIU's mandate is to replicate the composition and performance of an externally generated index or fixed basket of equities or debt securities; and
 - (b) a minimum correlation of 0.9 between daily price movements of the CIU and the index or basket of equities or debt securities it tracks can be clearly established over a minimum period of six months. 'Correlation' in this context means the correlation coefficient between daily returns on the CIU and the index or basket of equities or debt securities it tracks.
55. Where the institution is not aware of the underlying investments of the CIU on a daily basis, the institution may calculate the capital requirements for position risk (general and specific) in accordance with the methods set out in this Annex, subject to the following conditions:

Status: EU Directives are being published on this site to aid cross referencing from UK legislation. After IP completion day (31 December 2020 11pm) no further amendments will be applied to this version.

- (a) it will be assumed that the CIU first invests to the maximum extent allowed under its mandate in the asset classes attracting the highest capital requirement for position risk (general and specific), and then continues making investments in descending order until the maximum total investment limit is reached. The position in the CIU will be treated as a direct holding in the assumed position;
 - (b) institutions shall take account of the maximum indirect exposure that they could achieve by taking leveraged positions through the CIU when calculating their capital requirement for position risk, by proportionally increasing the position in the CIU up to the maximum exposure to the underlying investment items resulting from the mandate; and
 - (c) should the capital requirement for position risk (general and specific) according to this point exceed that set out in point 48, the capital requirement shall be capped at that level.
56. Institutions may rely on a third party to calculate and report capital requirements for position risk (general and specific) for positions in CIUs falling under points 53 and 55, in accordance with the methods set out in this Annex, provided that the correctness of the calculation and the report is adequately ensured.