91. Minimum holding periods

Where in respect of an exposure of an authorized institution, there is—

(*a*) a daily revaluation of the exposure and the recognized collateral provided in respect of the exposure; or

(*b*) a requirement that the obligor in respect of the exposure has to bring the value of the recognized collateral provided in respect of the exposure up to a value required under the terms of the transaction giving rise to the exposure based on the daily mark-to-market value of the exposure and the collateral (referred to in this Division as "daily remargining"),

the institution shall, for the purposes of determining whether adjustment of the standard supervisory haircuts applicable to the recognized collateral and the exposure under section 92 is needed, take the assumed minimum holding periods to be as set out in Table 12 based on the type of the transaction giving rise to the exposure.

TABLE 12

ASSUMED MINIMUM HOLDING PERIODS

Type of transaction	Assumed minimum holding period	Condition
Repo-style transactions	5 business days	Daily remargining
Other capital market transactions	10 business days	Daily remargining
Secured lending transactions	20 business days	Daily revaluation

92. Adjustment of standard supervisory haircuts in certain circumstances

Where for the purposes of section 87, 88, 89, 90, 94, 95, 96 or 100—

(*a*) the assumed minimum holding period of a transaction giving rise to an exposure of an authorized institution is not 10 business days; or

(*b*) the exposure of an authorized institution and the recognized collateral provided to the institution in respect of the exposure, are not subject to daily remargining or daily revaluation as assumed in the standard supervisory haircuts,

the institution shall adjust the standard supervisory haircuts by the use of Formula 6.

FORMULA 6

ADJUSTMENT OF STANDARD SUPERVISORY HAIRCUTS FOR CIRCUMSTANCES SET OUT IN SECTION 92

$$H = H_{10} \times \sqrt{\frac{N_R + (T_M - 1)}{10}}$$

where—

H = haircut after adjustment for differences in assumed minimum holding period and remargining and revaluation frequency;

H_{10} = standard supervisory haircuts based on an assumed minimum holding period of 10 business days, daily remargining and daily revaluation;

N_R = actual number of days between each remargining or each revaluation of the recognized collateral; and

T_M = assumed minimum holding period for a particular type of transaction as set out in Table 12.

93. Calculation of risk-weighted amount of collateralized transactions under comprehensive approach

An authorized institution shall calculate the risk-weighted amount of each of its exposures which is a collateralized transaction by multiplying the net credit exposure of the institution to the obligor by the risk-weight attributable to the exposure.

Division 8—Use of recognized netting in credit risk mitigation

94. On-balance sheet netting

(1) Where amounts owed by an obligor to an authorized institution in respect of on-balance sheet exposures of the institution are subject to recognized netting, the institution—

(*a*) may take into account the effect of the recognized netting in calculating its exposure to the obligor; and

(*b*) if a net credit exposure for the institution is the result of so taking into account the effect of the recognized netting, shall use the net credit exposure in calculating the risk-weighted amount of the exposure.

(2) An authorized institution shall calculate its net credit exposure, if any, referred to in subsection (1)(*b*) by the use of Formula 7.

FORMULA 7

Calculation of Net Credit Exposure under Recognized Netting

$$\text{Net credit exposure} = \max [0, \text{exposures} - \text{liabilities} \times (1 - H_{fx})]$$

where—

exposures	=	the amounts subject to recognized netting, net of specific provisions, owed by the obligor to the authorized institution;
liabilities	=	the amounts subject to recognized netting owed by the authorized institution to the obligor; and
H_{fx}	=	haircut applicable in consequence of a currency mismatch, if any, between the currencies in which the exposures and liabilities are denominated pursuant to the standard supervisory haircuts applicable to currency mismatch set out in Schedule 7 subject to adjustment as set out in section 92.

(3) Where an authorized institution has a net credit exposure to an obligor after taking into account recognized netting, the institution shall calculate the risk-weighted amount of the net credit exposure by multiplying the net credit exposure by the attributed risk-weight of the obligor.

95. Netting of OTC derivative transactions and netting of credit derivative contracts booked in trading book

(1) Where an authorized institution's exposure to a counterparty is under a nettable derivative transaction (whether or not the recognized netting concerned relates to more than one type of nettable derivative transaction), the institution may, in accordance with subsections (2) and (3), take into account the effect of the recognized netting in calculating the risk-weighted amount of its net credit exposure to the counterparty.

(2) Subject to subsection (3), an authorized institution shall calculate the credit equivalent amount of its net credit exposure to a counterparty by adding together—

(*a*) the net current exposure (being the sum of the positive and negative mark-to-market replacement costs of the individual nettable derivative transactions subject to recognized netting if the sum is positive); and

(*b*) the net potential exposure calculated by the use of Formula 8.

FORMULA 8

Calculation of Net Potential Exposure under Nettable Derivative Transactions

$$A_{Net} = 0.4 \times A_{Gross} + 0.6 \times NGR \times A_{Gross}$$

where—

A_{Net}	=	the net potential exposure;
A_{Gross}	=	the sum of the individual amounts derived by multiplying the principal amounts of all of the individual nettable derivative transactions by the applicable CCFs; and
NGR	=	the ratio of net replacement cost for the nettable derivative transactions (that is, the non-negative sum of the positive and negative mark-to-market replacement costs of the transactions) to gross replacement cost for the nettable derivative transactions (that is, the sum of the positive mark-to-market replacement costs of the transactions).

(3) An authorized institution, in the application of Formula 8 in respect of its nettable derivative transactions, shall calculate the NGR in that Formula either on a per counterparty basis, or on an aggregate basis.

(4) An authorized institution shall allocate to the credit equivalent amount of its net credit exposure to the counterparty calculated in accordance with subsection (2), net of specific provisions, the attributed risk-weight of the counterparty.

(5) Where a net credit exposure to a counterparty is covered by recognized collateral under the comprehensive approach to the treatment of recognized collateral, Formula 4 shall, with all necessary modifications, be used by the authorized institution to calculate the credit equivalent amount after taking into account the effect of the recognized collateral.

(6) In this section—

"aggregate basis" (總和基準), in relation to the calculation of the NGR in Formula 8, means the ratio of the sum of the net replacement costs for all nettable derivative transactions with each counterparty to the sum of gross replacement costs for all nettable derivative transactions with each counterparty;

"derivative transaction" (衍生工具交易) means—

(*a*) an OTC derivative transaction; or

(*b*) a credit derivative contract booked in the trading book;

"per counterparty basis" (每位對手方基準), in relation to the calculation of the NGR in Formula 8, means the ratio of net replacement cost to gross replacement cost for the nettable derivative transactions with a particular counterparty.

96. Netting of repo-style transactions

(1) An authorized institution which uses the comprehensive approach in its treatment of recognized collateral shall not take into account the effect of recognized netting covering the institution's repo-style transactions in the calculation of its capital adequacy ratio insofar as it relates to credit risk other than in accordance with the provisions of this section.

(2) Where under nettable repo-style transactions the subject of recognized netting an authorized institution has the same counterparty, the institution shall calculate—

(*a*) the aggregate value of all money and securities sold, transferred, loaned or paid to the counterparty; and

(*b*) the aggregate value of money and securities received by the institution consisting of—

(i) in the case of repo-style transactions booked in the institution's banking book, securities which would be recognized collateral falling within section 80(*a*), (*b*) or (*c*) under the comprehensive approach to the treatment of recognized collateral; and

(ii) in the case of repo-style transactions booked in the institution's trading book, any securities.

(3) Subject to section 97, where, in respect of a calculation under subsection (2) made by an authorized institution in respect of a counterparty, the aggregate value referred to in subsection (2)(*a*) is greater than the aggregate value referred to in subsection (2)(*b*), the institution shall calculate its net credit exposure to the counterparty by the use of Formula 9.

FORMULA 9

CALCULATION OF NET CREDIT EXPOSURE TO COUNTERPARTY WHERE AGGREGATE VALUE REFERRED TO IN SECTION 96(2)(*a*) IS GREATER THAN AGGREGATE VALUE REFERRED TO IN SECTION 96(2)(*b*)

$$E^{\#} = \max \{0, [(\Sigma(E) - \Sigma(C)) + \Sigma(E_s \times H_s) + \Sigma(E_{fx} \times H_{fx})]\}$$

where—

$E^{\#}$ = net credit exposure;

E = current market value of money and securities sold, transferred, loaned or paid by the authorized institution;

C = current market value of money and securities received by the authorized institution;

E_s = absolute value (irrespective of positive or negative) of the net position in the same securities;

H_s = haircut applicable to the absolute value of the net position in the same securities (that is, E_s) pursuant to the standard supervisory haircuts for the comprehensive approach to the treatment of recognized collateral subject to adjustment as set out in section 92;

E_{fx} = absolute value of the net position in a currency different from the settlement currency; and

H_{fx} = haircut applicable in consequence of a currency mismatch, if any, between the currency in which a net position is denominated and the settlement currency pursuant to the standard supervisory haircut for currency mismatch set out in Schedule 7 subject to adjustment as set out in section 92.

(4) An authorized institution shall allocate to its net credit exposure to a counterparty, calculated in accordance with subsection (3), the attributed risk-weight of the counterparty.

(5) An authorized institution—

(*a*) subject to paragraph (*b*), shall net its nettable repo-style transactions booked in its banking book separately from netting its nettable repo-style transactions booked in its trading book and vice versa;

(*b*) may net repo-style transactions booked in its banking book with repo-style transactions booked in its trading book in respect of the same counterparty if—

(i) all those repo-style transactions are marked-to-market daily; and

(ii) all the securities received by the institution in respect of all those repo-style transactions are recognized collateral falling within section 80(*a*), (*b*) or (*c*) under the comprehensive approach to the treatment of recognized collateral.

97. Use of value-at-risk model instead of Formula 9

(1) Where under Part 2 the Monetary Authority has approved the use by an authorized institution of an internal model to measure the institution's exposure to market risk, the institution may, with the approval of the Monetary Authority under subsection (3) and in accordance with that approval, use an internal model based on VaR (referred to in this section as "VaR model") as an alternative to the use of Formula 9 for the purposes of calculating the institution's net credit exposure to a given counterparty under nettable repo-style transactions the subject of recognized netting.

(2) An authorized institution referred to in subsection (1) may make an application to the Monetary Authority for the Monetary Authority's approval to the institution using a VaR model for the purposes referred to in that subsection.

(3) Subject to subsections (4) and (5), the Monetary Authority shall determine an application under subsection (2) from an authorized institution by notice in writing given to the institution granting, or refusing to grant, the approval sought.

(4) The Monetary Authority shall refuse to grant approval under subsection (3) to an authorized institution unless the institution satisfies the Monetary Authority that, in the case of the VaR model in respect of which the approval is sought—

(*a*) the model will take into account any price relationship between the value of money and securities sold, transferred, loaned or paid by the institution and the value of money and securities received by the institution under nettable repo-style transactions, and, in particular in this regard, whether the prices have a positive relationship (that is, their prices move in the same direction) or negative relationship (that is, their prices move in the opposite direction), or have no relationship at all;

(*b*) the model will assume a minimum holding period of 5 days and that minimum holding period will be subject to increase to the extent that the liquidity of the securities provided by way of collateral under the nettable repo-style transactions is such that a longer minimum holding period should be assumed; and

(*c*) the quality of the model has proved acceptable pursuant to a prescribed demonstration of the model carried out by the institution.

(5) The Monetary Authority shall, in deciding whether to grant approval under subsection (3) in respect of a VaR model, take into account quantitative and qualitative requirements set out in Schedule 3.

(6) Where an authorized institution is granted approval under subsection (3) to use a VaR model for the purposes referred to in subsection (1), the institution shall calculate its net credit exposure to the counterparty under nettable repo-style transactions by the use of Formula 10.

FORMULA 10

Calculation of Net Credit Exposure to Counterparty under Nettable Repo-style Transactions Using VaR Model

$$E^* = \max \{0, [(\Sigma(E) - \Sigma(C)) + \text{VaR output} \times \text{multiplier}]\}$$

where—

E^*	=	net credit exposure;
E	=	current market value of money and securities sold, transferred, loaned or paid by the authorized institution;
C	=	current market value of money and securities received by the authorized institution as collateral;
VaR output	=	the VaR number generated by the VaR model in respect of the previous business day; and
multiplier	=	the relevant multiplier derived in accordance with subsection (7) and Table 13.

TABLE 13

MULTIPLIER FOR EXCEPTIONS

Number of exceptions	Multiplier
0 – 19	None (=1)
20 – 39	None (=1)
40 – 59	None (=1)
60 – 79	None (=1)
80 – 99	None (=1)
100 – 119	1.13
120 – 139	1.17
140 – 159	1.22
160 – 179	1.25
180 – 199	1.28
200 or more	1.33

(7) The multiplier to be applied under Formula 10 shall be derived by reference to the number of exceptions identified, during back-testing pursuant to the method used in a prescribed demonstration, over the most recent 250 trading days and by mapping the number of exceptions in column 1 of Table 13 and taking as the multiplier the figure in column 2 of that Table against the relevant number of exceptions in column 1 of that Table.

(8) In this section—

"prescribed demonstration" (訂明示範), in relation to a VaR model proposed to be used by an authorized institution for the purposes referred to in subsection (1), means a demonstration—

(*a*) which back-tests the output of the model using a sample of 20 counterparties in respect of repo-style transactions with data covering a one-year period where the counterparties include—

(i) the institution's 10 largest counterparties; and

(ii) 10 counterparties selected at random; and

(*b*) in which for each day, in respect of the institution's exposure to the sample of 20 counterparties on the previous day (referred to in this paragraph as "previous day's exposure"), the institution compares its VaR estimate for the previous day's exposure to the actual change in value of the previous day's exposure, and—

(i) where the actual change in value of the previous day's exposure is calculated as the difference between the net value of that exposure calculated using today's market prices and the net value of that exposure calculated using the previous day's market prices;

(ii) where if the change exceeds the previous day's estimate, an exception occurs.

Division 9—Use of recognized guarantees and recognized credit derivative contracts in credit risk mitigation

98. Recognized guarantees

A guarantee given to an authorized institution is recognized for the purposes of calculating the risk-weighted amount of an exposure of the institution where—

(*a*) the guarantee is given by—

(i) a sovereign;

(ii) a public sector entity;

(iii) a multilateral development bank;

(iv) a bank;

(v) a securities firm; or

(vi) a corporate which has an ECAI issuer rating which, if mapped to the scale of credit quality grades in Table C in Schedule 6, would result in the corporate being assigned a credit quality grade of 1 or 2,

in each case having been allocated a lower risk-weight than that allocated to the exposure in respect of which the guarantee has been given (referred to in this section as "guaranteed exposure");

(*b*) the guarantee gives the institution a direct claim against the guarantor;

(*c*) the credit protection provided by the guarantee relates to a specific exposure, specific exposures, or specific pools of exposures, of the institution;

(*d*) the undertaking of the guarantor to make payment in specified circumstances relating to the guaranteed exposure is clearly documented so that the extent of the credit protection provided by the guarantee is clearly defined;

(*e*) there is no clause in the guarantee, the satisfaction of which is outside the direct control of the institution, which would allow the guarantor to cancel the guarantee unilaterally or which would increase the effective cost of the credit protection provided by the guarantee as a result of the deteriorating credit quality of the guaranteed exposure except for a clause permitting termination in the event of a failure by the institution to pay sums due from it under the terms of the guarantee;

(*f*) there is no clause in the guarantee, the satisfaction of which is outside the direct control of the institution, which could operate to prevent the guarantor from being obliged to pay out promptly in the event that the obligor in respect of the guaranteed exposure defaults in making any payments due to the institution in respect of the guaranteed exposure;

(*g*) the country in which the guarantor is located and from which the guarantor may be obliged to make payment has no existing exchange controls in place or, if there are existing exchange controls in place, approval has been obtained for the funds to be remitted freely in the event that the guarantor is called upon under the terms of the guarantee to make payment to the institution;

(*h*) the guarantor has no recourse to the institution for any losses suffered as a result of the guarantor being obliged to make any payment to the institution pursuant to the guarantee;

(*i*) the institution has the right to receive payment from the guarantor without having to take legal action in order to pursue the obligor in respect of the guaranteed exposure for payment; and

(*j*) the guarantee is binding on all parties and legally enforceable in all relevant jurisdictions.

99. Recognized credit derivative contracts

(1) A credit derivative contract entered into by an authorized institution as a protection buyer is recognized for the purposes of calculating the risk-weighted amount of an exposure of the institution where—

(*a*) the credit derivative contract is a credit default swap or total return swap (other than a restricted return swap);

(*b*) the protection seller of the credit derivative contract is—

(i) a sovereign;

(ii) a public sector entity;

(iii) a multilateral development bank;

(iv) a bank;

(v) a securities firm; or

(vi) a corporate which has an ECAI issuer rating which, if mapped to the scale of credit quality grades in Table C in Schedule 6, would result in the corporate being assigned a credit quality grade of 1 or 2,

in each case having been allocated a lower risk-weight than that allocated to the exposure in respect of which the credit derivative contract has been entered into (referred to in this section as "protected exposure");

(*c*) the economic benefit derived by the institution would make good the economic loss suffered by the institution in consequence of the default of the obligor in respect of the protected exposure in a manner substantially similar to that of a recognized guarantee;

(*d*) the credit derivative contract gives the institution a direct claim against the protection seller;

(*e*) the credit protection provided by the credit derivative contract relates to a specific exposure, specific exposures, or specific pools of exposures, of the institution;

(*f*) the undertaking of the protection seller under the credit derivative contract to make payment in specified circumstances relating to the protected exposure is clearly documented so that the extent of the credit protection provided by the credit derivative contract is clearly defined;

(*g*) there is no clause in the credit derivative contract, the satisfaction of which is outside the direct control of the institution, which would allow the protection seller to cancel the contract unilaterally or which would increase the effective cost of the credit protection offered by the credit derivative contract as a result of the deteriorating credit quality of the protected exposure except for a clause permitting termination in the event of a failure by the institution to pay sums due from it under the terms of the credit derivative contract;

(*h*) there is no clause in the credit derivative contract, the satisfaction of which is outside the direct control of the institution, which could operate to prevent the protection seller from being obliged to pay out promptly in the event that the obligor in respect of the protected exposure defaults in making any payments due to the institution in respect of the protected exposure;

(*i*) the country in which the protection seller is located and from which the protection seller may be obliged to make payment has no existing exchange controls in place or, if there are existing exchange controls in place, approval has been obtained for the funds to be remitted freely in the event that the protection seller is called upon under the terms of the credit derivative contract to make payment to the institution;

(*j*) the protection seller has no recourse to the institution for any losses suffered as a result of the protection seller being obliged to make any payment to the institution pursuant to the credit derivative contract;

(*k*) the credit derivative contract obliges the protection seller to make payment to the institution in the following credit events—

(i) any failure by the obligor in respect of the protected exposure to pay amounts due under the terms of the protected exposure (subject to any grace period in the contract which is of substantially similar duration to any grace period provided for in the terms of the protected exposure);

(ii) the bankruptcy or insolvency of (or analogous events affecting) the obligor in respect of the protected exposure or the obligor's failure or inability to pay its debts as they fall due or the obligor's admission in writing of the obligor's inability generally to pay its debts as they fall due; or

(iii) subject to subsections (2) and (3), the protected exposure is restructured, involving forgiveness or postponement of payment of any principal or interest or fees, which results in the institution making any deduction or specific provision or other similar debit to the institution's profit and loss account;

(*l*) in any case where the protected exposure provides a grace period within which the obligor may make good a default in payment, the credit derivative contract is not capable of terminating prior to the expiry of the grace period;

(*m*) in any case where the credit derivative contract provides for settlement in cash, it provides an adequate mechanism for valuation of the loss occasioned to the institution in respect of the protected exposure and specifies a reasonable period within which that valuation is to be arrived at following a credit event;

(*n*) in any case where the reference obligation or the obligation used for the purposes of determining whether a credit event has occurred as specified in the credit derivative contract (referred to in this paragraph as "specified obligation") does not include or is different from the protected exposure—

(i) the specified obligation of the credit derivative contract ranks for payment or repayment equally with, or junior to, the protected exposure; and

(ii) the obligor in respect of the protected exposure is the same person as the obligor in respect of the specified obligation and legally enforceable cross default or cross acceleration clauses are included in the terms of both the protected exposure and the specified obligation;

(*o*) in any case where under the terms of the credit derivative contract it is a condition of settlement that the institution transfers its rights in respect of the protected exposure to the protection seller, the terms of the protected exposure provide that any consent which may be required from the obligor in respect of the protected exposure shall not be unreasonably withheld;

(*p*) the credit derivative contract specifies clearly the identity of the person who is empowered to determine whether a credit event has occurred, that person is not solely the protection seller and the institution is, under the terms of the credit derivative contract, entitled to inform the protection seller of the occurrence of a credit event; and

(*q*) the credit derivative contract is binding on all parties and legally enforceable in all relevant jurisdictions.

(2) Where any restructuring of the protected exposure to which a credit derivative contract relates does not, under the terms of the contract, require payment by the protection seller to the authorized institution concerned but the maximum liability of the protection seller to the institution under the credit derivative contract is more than the amount of the protected exposure, the contract shall be deemed to be a recognized credit derivative contract to the extent of 60% of the amount of the protected exposure.

(3) Where any restructuring of the protected exposure to which a credit derivative contract relates does not, under the terms of the contract, require payment by the protection seller to the authorized institution concerned but the maximum liability of the protection seller to the institution under the credit derivative contract is less than, or equal to, the amount of the protected exposure, the contract shall be deemed to be a recognized credit derivative contract to the extent of 60% of the maximum liability of the protection seller to the institution under the credit derivative contract.

(4) In this section—

"restricted return swap" (受限制回報掉期), in relation to an authorized institution, means a total return swap where—

(*a*) the institution is the protection buyer under the swap; and

(*b*) the institution records the net payments received by it under the swap as net income but does not record, through deductions in fair value in the accounts of the institution or by an addition to reserves or provisions, the extent to which the value of the protected exposure has deteriorated.

100. Capital treatment of recognized guarantees and recognized credit derivative contracts

(1) Subject to subsections (2), (3), (4), (5), (6), (7), (8) and (9), where an authorized institution's exposure is covered by a recognized guarantee or recognized credit derivative contract, the institution may allocate to the exposure the attributed risk-weight of the credit protection provider.

(2) Subject to subsections (3), (4), (5), (6), (7), (8) and (9), where—

(*a*) the credit protection covered portion of an authorized institution's exposure is covered by a recognized guarantee or recognized credit derivative contract; and

(*b*) the credit protection covered portion and the credit protection uncovered portion of the exposure rank equally,

the institution shall—

(*c*) allocate to the credit protection covered portion of the exposure the attributed risk-weight of the credit protection provider;

(*d*) allocate to the credit protection uncovered portion of the exposure the risk-weight attributable to the exposure.

(3) Sections 83, 84 and 85, with all necessary modifications, apply to an authorized institution in relation to the calculation of the risk-weighted amount of exposures covered by recognized guarantees or recognized credit derivative contracts.

(4) Where in respect of an authorized institution's exposure covered by a recognized guarantee or recognized credit derivative contract there is a currency mismatch, then, to the extent that a calculation required by subsection (3) by the institution relates to that guarantee or contract, as the case may be, the institution shall adjust the credit protection covered portion by the use of Formula 11.

FORMULA 11

CALCULATION OF AMOUNT OF CREDIT PROTECTION OF RECOGNIZED GUARANTEE OR RECOGNIZED CREDIT DERIVATIVE CONTRACT WHERE THERE IS CURRENCY MISMATCH

$$G_a = G \times (1 - H_{fx})$$

where—

G_a = credit protection covered portion adjusted for a currency mismatch;

G = maximum liability of the credit protection provider to the authorized institution under the credit protection; and

H_{fx} = haircut applicable in consequence of a currency mismatch pursuant to the standard supervisory haircuts for the comprehensive approach to the treatment of recognized collateral subject to adjustment as set out in section 92.

(5) Where—

(*a*) section 56(2) is applicable to domestic currency exposure to a sovereign; and

(*b*) the credit protection covered portion of an authorized institution's exposure—

(i) is funded in the local currency of that sovereign; and

(ii) is the subject of a recognized guarantee by that sovereign denominated in the local currency,

the institution may allocate the lower risk-weight provided for by section 56(2) to that credit protection covered portion.

(6) Where—

(*a*) section 56(3) is applicable to domestic currency exposure to a sovereign; and

(*b*) the credit protection covered portion of an authorized institution's exposure—
(i) is funded in the local currency of that sovereign;
(ii) is an exposure arising from a loan; and
(iii) is the subject of a recognized guarantee by that sovereign denominated in the local currency,

the institution may allocate the risk-weight provided for by section 56(3)(*c*) to that credit protection covered portion.

(7) Where—
(*a*) section 56(3) is applicable to domestic currency exposure to a sovereign; and
(*b*) the credit protection covered portion of an authorized institution's exposure—
(i) is funded in the local currency of that sovereign;
(ii) is an exposure arising from fixed rate debt securities with a residual maturity of less than one year or floating rate debt securities of any maturity; and
(iii) is the subject of a recognized guarantee by that sovereign denominated in the local currency,

the institution may allocate the risk-weight provided for by section 56(3)(*d*) to that credit protection covered portion.

(8) Where—
(*a*) section 56(3) is applicable to domestic currency exposure to a sovereign; and
(*b*) the credit protection covered portion of an authorized institution's exposure—
(i) is funded in the local currency of that sovereign;
(ii) is an exposure arising from fixed rate debt securities with a residual maturity of not less than one year; and
(iii) is the subject of a recognized guarantee by that sovereign denominated in the local currency,

the institution may allocate the risk-weight provided for by section 56(3)(*e*) to that credit protection covered portion.

(9) Where the credit protection covered portion of an authorized institution's exposure—
(*a*) is such credit protection covered portion by virtue of a recognized guarantee (referred to in this subsection as "original guarantee"); and
(*b*) is the subject of a counter-guarantee given by a sovereign,

the institution may, in respect of the credit protection covered portion, treat the counter-guarantee as if it were the original guarantee if—

(*c*) the counter-guarantee covers all credit risk elements of the exposure to the extent that it relates to the credit protection covered portion;

(*d*) the counter-guarantee is given in such terms that it can be called if for any reason the obligor in respect of the exposure to which the original guarantee relates fails to make payments due in respect of the exposure and if the original guarantee could be called;

(*e*) the original guarantee and the counter-guarantee meet all of the requirements for guarantees set out in section 98 (except that the counter-guarantee need not be a guarantee given directly and explicitly with respect to the institution's exposure to which the original guarantee relates); and

(*f*) the institution reasonably considers the cover of the counter-guarantee to be adequate and effective and there is no evidence to suggest that the coverage of the counter-guarantee is less effective than that of a direct and explicit guarantee by the sovereign which gives the counter-guarantee.

101. Provisions supplementary to section 100

(1) Where the credit protection in respect of an authorized institution's exposure consists of a recognized credit derivative contract which is a credit default swap or total return swap—

(*a*) if upon the happening of a credit event the protection seller is obliged to pay the amount specified in the contract to the institution in exchange for delivery by the institution of the deliverable obligation specified in the contract, the institution may treat the exposure as being fully covered;

(*b*) if upon the happening of a credit event the protection seller is obliged to pay the amount specified in the contract to the institution less the market value of the reference obligation specified in the contract, calculated by specified calculation agents at some specified point in time after the credit event has occurred, the institution may treat the exposure as being fully covered; and

(*c*) if upon the happening of a credit event the protection seller is obliged to pay a fixed amount to the institution, the institution may only treat that amount of the exposure which is equivalent to the fixed amount as being fully covered.

(2) Where the credit protection in respect of an authorized institution's exposure consists of a recognized credit derivative contract which provides that, upon the happening of a credit event—

(*a*) the protection seller is not obliged to make a payment in respect of any loss until the loss exceeds a specified amount (referred to in this subsection as "first loss portion"); and

(*b*) the protection seller is not obliged to make a payment in respect of any loss except to the extent that the loss exceeds the first loss portion,

the institution shall, in calculating its capital adequacy ratio, deduct the first loss portion from its core capital and supplementary capital.

(3) Where the credit protection in respect of a basket of exposures of an authorized institution consists of a recognized first-to-default credit derivative contract—

(*a*) the institution shall recognize that credit protection for the exposure in the basket of exposures which would carry the lowest risk-weighted amount in the absence of the credit protection amongst the exposures in the basket only if the principal amount of the exposure is not more than the notional amount of the contract; and

(*b*) in the case of such credit protection so recognized, the institution may allocate to the exposure within the basket which would carry the lowest risk-weighted amount in the absence of the credit protection the attributed risk-weight of the credit protection provider.

(4) Where the credit protection in respect of a basket of exposures of an authorized institution consists of a recognized second-to-default credit derivative contract, the institution may, to the extent of the coverage of the credit protection, allocate to the exposure within the basket which would carry the second lowest risk-weighted amount in the absence of the credit protection the attributed risk-weight of the credit protection provider only if—

(*a*) the institution has, as a protection buyer, entered into a recognized first-to-default credit derivative contract in respect of which the basket of reference obligations, or the basket of obligations used for the purposes of determining whether a credit event has occurred as specified in the contract, is the same as the basket of reference obligations or the basket of obligations used for the purposes of determining whether a credit event has occurred as specified in the second-to-default credit derivative contract (referred to in this subsection as "relevant basket"); or

(*b*) an exposure in the relevant basket has defaulted.

(5) Where the credit protection in respect of a basket of exposures of an authorized institution consists of a recognized subsequent-to-default credit derivative contract, the institution may, with all necessary modifications, apply subsection (4) to that contract as that subsection is applied to a second-to-default credit derivative contract so that—

(*a*) the reference to "a recognized first-to-default credit derivative contract in respect of which the basket of reference obligations, or the basket of obligations used for the purposes of determining whether a credit event has occurred as specified in the contract" in subsection (4)(*a*) is construed to mean "recognized first-to-default and second-to-default credit derivative contracts in respect of which the basket of reference obligations, or the basket of obligations used for the purposes of determining whether a credit event has occurred as specified in each contract"; and

(*b*) the reference to "an exposure in the relevant basket has" in subsection (4)(*b*) is construed to mean "2 exposures in the relevant basket have",

in the case of a third-to-default credit derivative contract and likewise for other subsequent-to-default credit derivative contracts.

(6) Where the credit protection in respect of a basket of exposures of an authorized institution is a credit derivative contract which provides credit protection proportionately to reference obligations in the basket of reference obligations as specified in the contract, the institution shall calculate the risk-weighted amount of its exposures by substituting the attributed risk-weight of the credit protection provider for the risk-weights of the exposures to the extent of the coverage of the credit protection.

(7) Where—

(*a*) an authorized institution has entered into a transaction under which a portion of the credit risk of an exposure it has is transferred in one or more than one tranche to one or more than one credit protection provider, and the other portion of the credit risk of the exposure is retained by the institution; and

(*b*) the portion of credit risk transferred and the portion of the credit risk retained are of different seniority,

the institution shall treat the transaction as a securitization transaction and determine the treatment of the exposure in accordance with the relevant provisions of Part 7.

(8) Where the credit protection in respect of an authorized institution's exposure takes the form of an issue of credit-linked notes by the institution, the institution—

(*a*) may only treat that amount of the exposure which is equivalent to the cash funding received from the notes as being fully covered;

(*b*) shall treat the credit protection covered portion of the exposure as an exposure collateralized by cash deposit; and

(*c*) shall deduct from the institution's core capital and supplementary capital the first loss portion, being any specified amount of loss, upon the happening of a credit event, below which the protection seller is not obliged to share in the loss.

Division 10—Multiple recognized credit risk mitigation and maturity mismatches

102. Multiple recognized credit risk mitigation

(1) Where in respect of a single exposure of an authorized institution to an obligor, 2 or more forms of recognized credit risk mitigation have been used by the institution, the institution shall calculate the risk-weighted amount of the exposure in accordance with these Rules by dividing the exposure into the portions which respectively represent the proportions of the exposure covered by each of the forms of recognized credit risk mitigation so used.

(2) Where in respect of a single exposure of an authorized institution to an obligor, there is an overlap of coverage between 2 or more forms of recognized credit risk mitigation used by the institution, the institution may select, in respect of the portion of the exposure covered by the overlap, the recognized credit risk mitigation which result in the lowest risk-weighted amount of that portion of the exposure covered by the overlap.

(3) Where an authorized institution has an exposure to an obligor in respect of which credit protection has been provided by a single credit protection provider in circumstances where the relevant credit protection has different maturities, the institution shall calculate the risk-weighted amount of the exposure in accordance with these Rules by dividing the exposure into different portions reflecting the maturity of the credit protection respectively attributable to the different portions.

(4) Where an authorized institution has an exposure to an obligor in the form of a general banking facility consisting of 2 or more credit lines—

(*a*) the institution may, in calculating its risk-weighted amount in respect of the credit lines, allocate any credit protection taken in respect of the exposure amongst the individual exposures under each of the credit lines; and

(*b*) if the institution exercises its discretion under paragraph (*a*), the institution shall aggregate the risk-weighted amounts of the individual exposures under each of the credit lines to determine the total risk-weighted amount of the exposure in respect of the general banking facility.