Annex 1

Basel Committee's adjustments to Basel II market risk framework

1. Transitional arrangement for securitization positions which are not included in correlation trading portfolio (CTP)[1]

During the two-year transitional period until 31 December 2013, the determination of the market risk capital charge for specific risk (i.e. the specific risk capital charge) in respect of securitization positions in the trading book which are not included in the CTP will be based on the larger of (i) the total specific risk capital charge that would apply just to the net long positions; and (ii) the total specific risk capital charge that would apply just to the net short positions. After the transitional period, the specific risk capital charge for those securitization positions will be the sum of specific risk capital charges calculated under (i) and (ii) above.

2. Limitation of specific risk capital charge to maximum possible loss

The specific risk capital charge for individual securitization positions and credit derivative contracts in the trading book will be subject to the maximum possible loss. For a short risk position, the limit for maximum possible loss could be calculated as a change in value due to the underlying names immediately becoming default risk-free. For a long risk position, the limit could be calculated as a change in value in the event that all the underlying names were to default with zero recoveries. The maximum possible loss must be calculated for each individual position.

3. Floor to comprehensive risk charge for CTP under internal models approach

Where a bank using the internal models approach has the supervisory approval to adopt an internally developed approach to calculate the comprehensive risk charge, the bank is required to subject its CTP positions to a capital charge equal to the higher of (i) the capital charge calculated according to the internally developed approach; and (ii) 8% of the specific risk capital charge calculated according to the standardized (market risk) approach.

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[1] "Correlation trading portfolio" (CTP) refers to securitization exposures and n-th-to-default credit derivative contracts that meet these criteria: (i) the positions are neither resecuritization positions, nor derivatives of securitization exposures that do not provide a pro-rata share in the proceeds of a securitization tranche; and (ii) all reference entities are single-name products, including single-name credit derivative contracts, for which a liquid two-way market exists. Positions that hedge the above positions and which are neither securitization exposures nor n-th-to-default credit derivative contracts and where a liquid two-way market exists for the exposures or the underlying exposures, are included in the CTP. However, positions which reference an underlying exposure that is treated as a retail exposure, a residential mortgage loan or a commercial mortgage loan, or positions which reference a claim on a special purpose entity are excluded from the CTP.