(v) A bank may offset long and short positions (both actual and notional) in identical derivative instruments with exactly the same issuer, coupon, currency, and maturity before slotting these positions into time-bands. A matched position in a future and its corresponding underlying may also be fully offset and, thus, excluded from the calculation, except when the future comprises a range of deliverable instruments. However, in cases where, among the range of deliverable instruments, there is a readily identifiable underlying instrument that is most profitable for the trader with a short position to deliver, positions in the futures contract and the instrument may be offset. No offsetting is allowed between positions in different currencies.

(vi) Offsetting positions in the same category of instruments can in certain circumstances be regarded as matched and treated by the bank as a single net position which should be entered into the appropriate time-band. To qualify for this treatment the positions must be based on the same underlying instrument, be of the same nominal value, and be denominated in the same currency. The separate sides of different swaps may also be ''matched'' subject to the same conditions. In addition:

(A) For futures, offsetting positions in the notional or underlying instruments to which the futures contract relates must be for identical instruments and the instruments must mature within seven days of each other;

(B) For swaps and FRAs, the reference rate (for floating rate positions) must be identical and the coupon closely matched; and

(C) For swaps, FRAs and forwards, the next interest reset date, or for fixed coupon positions or forwards the remaining maturity, must correspond within the following limits: If the reset (remaining maturity) dates occur within one month, then the reset (remaining maturity) dates must be on the same day; if the reset (remaining maturity) dates occur between one month and one year later, then the reset (remaining maturity) dates must occur within seven days of each other, or if the reset (remaining maturity) dates occur over one year later, then the reset (remaining maturity) dates must occur within thirty days of each other.

(vii) Interest rate and currency swaps, FRAs, forward foreign exchange contracts and interest rate futures are not subject to a specific risk charge. This exemption also applies to futures on a short-term (e.g., LIBOR) interest rate index. However, in the case of futures contracts where the underlying is a debt security, or an index representing a basket of debt securities, a specific risk charge will apply according to the category of the issuer as set out in section 6(a)(2) of this appendix B.

(b) *Equities.* (1) *Specific risk.* The measure of specific risk is calculated on the basis of the bank's gross equity positions, that is, the absolute sum of the current market value of all long equity positions and of all short equity positions.[11] The specific risk capital requirement is 8.0 percent of that sum, unless the portfolio is both liquid and well-diversified, in which case the specific risk capital requirement is 4.0 percent of the gross equity position. A specific risk charge of 2.0 percent applies to the net long or short position in a broad, diversified equity index.

(2) *General market risk.* The measure of general market risk is based on the difference between the sum of the long positions and the sum of the short positions (i.e., the overall net position in an equity market) at current market value. An overall net position must be separately calculated for each national market in which the bank holds equities. The capital requirement for general market risk is 8.0 percent of the net position in each equity market.

(3) *Equity derivatives.* (i) Equity derivatives and other off-balance-sheet positions that are affected by changes in equity prices are included in the measurement system under section 6(b) of this appendix B (except for equity options, equity index options, and the associated underlying, which are included in the measurement system under the treatment discussed in section 6(e) of this appendix B).[12] This includes futures and swaps on both individual equities and on equity indices. Equity derivatives should be converted into notional equity positions in the relevant underlying.

(ii) Futures and forward contracts relating to individual equities should be reported as current market prices of the underlying. Futures relating to equity indices should be reported as the marked-to-market value of the notional underlying equity portfolio. Equity swaps are treated as two notional positions, with the receiving side as the long position and the paying side as the short position.[13] If one of the legs involves receiving/paying a fixed or floating interest rate, the exposure should be slotted into the appropriate repricing maturity band for debt securities. The stock index is covered by the equity treatment.

(iii) In the case of futures-related arbitrage strategies, the 2.0 percent specific risk charge applicable to broad diversified equity indices may be applied to only one index. The opposite position is exempt from a specific risk charge. The strategies qualifying for this treatment are:

(A) When the bank takes an opposite position in exactly the same index at different dates; and

(B) When the bank has an opposite position in different but similar indices at the same date, subject to supervisory oversight.

(iv) If a bank engages in a deliberate arbitrage strategy, in which a futures contract on a broad diversified equity index matches a basket of securities, it may exclude both positions from the standardized approach on the condition that the trade has been deliberately entered into and separately controlled and the composition of the basket of stocks represents at least 90 percent of the market value of the index. In such a case, the minimum capital requirement is 4.0 percent (that is, 2.0 percent of the gross value of the positions on each side). This applies even if all of the securities comprising the index are held in identical proportions. Any excess value of the securities comprising the basket over the value of the futures contract or excess value of the futures contract over the value of the basket is treated as an open long or short position.

(v) If a bank takes a position in depository receipts[14] against an opposite position in the underlying equity, it may offset the position.

(c) *Foreign Exchange Risk.* (1) The capital requirement for foreign exchange risk covers the risk of holding or taking positions in foreign currencies, including gold, and is based on a bank's net open long positions or net open short positions in each currency, whether or not those positions are in the trading portfolio, plus the net open position in gold, regardless of sign.[15]

(2) A bank's net open position in each currency (and gold) is calculated by summing:

(i) The net spot position (i.e., all asset items less all liability items, including accrued interest earned but not yet received and accrued expenses, denominated in the currency in question);

(ii) All foreign exchange derivative instruments and other off-balance-sheet positions that are affected by changes in exchange rates are included in the measurement system under section 6(c) of this appendix B (except for options and their associated underlyings, which are included in the measurement system under the treatment discussed in section 6(e) of this appendix B). Forward currency positions should be valued at current spot market exchange rates. For a bank in which the basis of its normal management accounting is to use net present values, forward positions may be discounted to net present values as an acceptable way of measuring currency positions for regulatory capital purposes;

(iii) Guarantees (and similar instruments) that are certain to be called and are likely to be irrevocable;

(iv) Net future income/expenses not yet accrued but already fully hedged (at the discretion of the bank). A bank that includes future income and expenses must do so on a consistent basis without selecting expected future flows in order to reduce the bank's position; and

(v) Any other item representing a profit or loss in foreign currencies.

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[11] Matched positions in each identical equity in each national market may be treated as offsetting and excluded from the capital calculation, with any remaining position included in the calculations for specific and general market risk. For example, a future in a given equity may be offset against an opposite cash position in the same equity.

[12] Where equities are part of a forward contract (both equities to be received or to be delivered), any interest rate or foreign currency exposure from the other side of the contract should be appropriately included in sections 6(a) and (c) of this appendix B.

[13] For example, an equity swap in which a bank is receiving an amount based on the change in value of one particular equity or equity index and paying a different index will be treated as a long position in the former and a short position in the latter.

[14] Depository receipts are instruments issued by a trust company or other depository institution evidencing the deposit of foreign securities and facilitating trading in such instruments on U.S. stock exchanges.

[15] Where a bank has future and forward contracts to deliver and receive gold, a maturity ladder should be constructed in accordance with section 6(a) of this appendix B treating gold as a zero coupon instrument.