Chapter 5

Credit risk mitigation

5.8 Maturity mismatches

5.8.1 R For the purposes of calculating *risk weighted exposure amounts*, a maturity mismatch occurs when the residual maturity of the credit protection is less than that of the protected *exposure*. Protection of less than three months residual maturity, the maturity of which is less than the maturity of the underlying *exposure*, must not be recognised.

[**Note**: *BCD* Annex VIII Part 4 point 1]

5.8.2 R Where there is a maturity mismatch the credit protection must not be recognised where the original maturity of the protection is less than 1 year.

[**Note**: *BCD* Annex VIII Part 4 point 2 (part)]

Definition of maturity

5.8.3 R Subject to a maximum of 5 years, the effective maturity of the underlying is the longest possible remaining time before the obligor is scheduled to fulfil its obligations. Subject to BIPRU 5.8.4 R, the maturity of the credit protection is the time to the earliest date at which the protection may terminate or be terminated.

[**Note**: *BCD* Annex VIII Part 4 point 3]

5.8.4 R Where there is an option to terminate the protection which is at the discretion of the protection seller, the maturity of the protection must be taken to be the time to the earliest date at which that option may be exercised. Where there is an option to terminate the protection which is at the discretion of the protection buyer and the terms of the arrangement at origination of the protection contain a positive incentive for the *firm* to call the transaction before contractual maturity, the maturity of the protection must be taken to be the time to the earliest date at which that option may be exercised; otherwise such an option may be considered not to affect the maturity of the protection.

[**Note**: *BCD* Annex VIII Part 4 point 4]

5.8.5 R Where a credit derivative is not prevented from terminating prior to expiration of any grace period required for a default on the underlying obligation to occur as a result of a failure to pay the maturity of the protection must be reduced by the amount of the grace period.

[**Note**: *BCD* Annex VIII Part 4 point 5]

Valuation of protection: Transactions subject to funded credit protection – financial collateral simple method

5.8.6 R BIPRU 5.8.7 R sets out the calculation for the valuation of transactions subject to *funded credit protection* under the *financial collateral simple method*.

5.8.7 R Where there is a mismatch between the maturity of the *exposure* and the maturity of the protection, the collateral must not be recognised.

[**Note**: *BCD* Annex VIII Part 4 point 6]

Valuation of protection: Transactions subject to funded credit protection – financial collateral comprehensive method

5.8.8 R BIPRU 5.8.9 R sets out the calculation for the valuation of transactions subject to *funded credit protection* under the *financial collateral comprehensive method*.

5.8.9 R

(1) The maturity of the credit protection and that of the *exposure* must be reflected in the adjusted value of the collateral according to the following formula:

$C_{VAM} = C_{VA} \text{ x } (t-t^*)/(T-t^*)$

where:

(a) C_{VA} is the volatility adjusted value of the collateral as specified in BIPRU 5.4.28 R or the amount of the *exposure*, whichever is the lowest;

(b) t is the number of years remaining to the maturity date of the credit protection calculated in accordance with BIPRU 5.8.3 R to BIPRU 5.8.5 R, or the value of T, whichever is the lower;

(c) T is the number of years remaining to the maturity date of the *exposure* calculated in accordance with BIPRU 5.8.3 R to BIPRU 5.8.5 R, or 5 years, whichever is the lower; and

(d) t^* is 0.25.

(2) C_{VAM} must be taken as C_{VA} further adjusted for maturity mismatch to be included in the formula for the calculation of the fully adjusted value of the *exposure* (E^*) set out at BIPRU 5.4.28 R.

[**Note**: *BCD* Annex VIII Part 4 point 7]

Valuation of protection: Transactions subject to unfunded credit protection

5.8.10 R BIPRU 5.8.11 R sets out the calculation for the valuation of transactions subject to *unfunded credit protection*.

5.8.11 R

(1) The maturity of the credit protection and that of the *exposure* must be reflected in the adjusted value of the credit protection according to the following formula:

$G_A = G^* \text{ x } (t-t^*)/(T-t^*)$

5

where:

(a) G^* is the amount of the protection adjusted for any currency mismatch;

(b) G_A is G^* adjusted for any maturity mismatch;

(c) t is the number of years remaining to the maturity date of the credit protection calculated in accordance with ■ BIPRU 5.8.3 R to ■ BIPRU 5.8.5 R, or the value of T, whichever is the lower;

(d) T is the number of years remaining to the maturity date of the *exposure* calculated in accordance with ■ BIPRU 5.8.3 R to ■ BIPRU 5.8.5 R, or 5 years, whichever is the lower; and

(e) t^* is 0.25.

(2) G_A is then taken as the value of the protection for the purposes of ■ BIPRU 5.7.16 R to ■ BIPRU 5.7.25 R.

[**Note**: *BCD* Annex VIII Part 4 point 8]