

Appendix CA-4

Capital treatment for failed trades and non-DvP transactions

Overarching principles

1. Banks are exposed to the risk associated with unsettled securities, commodities, and foreign exchange transactions from trade date. Irrespective of the booking or the accounting of the transaction, unsettled transactions must be taken into account for regulatory capital requirements purposes.
2. Banks should continue to develop, implement and improve systems for tracking and monitoring the credit risk exposures arising from unsettled and failed transactions as appropriate for producing management information that facilitates action on a timely basis. Banks must closely monitor securities, commodities, and foreign exchange transactions that have failed, starting the first day they fail.
3. Transactions settled through a delivery-versus-payment system (DvP)¹, providing simultaneous exchanges of securities for cash, expose firms to a risk of loss on the difference between the transaction valued at the agreed settlement price and the transaction valued at current market price (i.e. positive current exposure). Banks must calculate a capital requirement for such exposures if the payments have not yet taken place five business days after the settlement date. Transactions where cash is paid without receipt of the corresponding receivable (securities, foreign currencies, gold, or commodities) or, conversely, deliverables were delivered without receipt of the corresponding cash payment (non-DvP, or free-delivery) expose firms to a risk of loss on the full amount of cash paid or deliverables delivered. Banks that have made the first contractual payment/delivery leg must calculate a capital requirement for the exposure if the second leg has not been received by the end of the business day. The requirement increases if the second leg has not been received within five business days. The current rules set out specific capital charges that address these two kinds of exposures.
4. The following capital treatment is applicable to all transactions on securities, foreign exchange instruments, and commodities that give rise to a risk of delayed settlement or delivery. This includes transactions through recognized clearing houses and central counterparties that are subject to daily mark-to-market and payment of daily variation margins and that involve a mismatched trade. Repurchase and reverse repurchase agreements as well as securities lending and borrowing that have failed to settle are excluded from this capital treatment². The treatment does not apply to the instruments that are subject to the counterparty credit risk requirements (i.e. over-the-counter derivatives, exchange-traded derivatives, long settlement transactions, securities financing transactions).

¹ A mechanism in an exchange-for-value settlement system that ensures that the final transfer of one asset occurs if and only if the final transfer of (an) other asset(s) occurs. Assets could include monetary assets (such as foreign exchange), securities or other financial instruments. For the purpose of this Module, DvP transactions include payment-versus-payment (PvP) transactions (A mechanism in a foreign exchange settlement system which ensures that a final transfer of one currency occurs if and only if a final transfer of the other currency or currencies takes place).

² All repurchase and reverse repurchase agreements as well as securities lending and borrowing, including those that have failed to settle, are treated in accordance with relevant sections in other modules.

5. Where they do not appear on the balance sheet (i.e. settlement date accounting), the unsettled exposure amount will receive a 100% credit conversion factor to determine the credit equivalent amount.
6. Failure of counterparty to settle a trade in itself will not be deemed a default for purposes of credit risk under this Module.

Capital Requirements

7. For DvP transactions, if the payments have not yet taken place five business days after the settlement date, firms must calculate a capital charge by multiplying the positive current exposure of the transaction by the appropriate factor, according to the Table 1 below.

Table 1

Number of working days after the agreed settlement date	Corresponding risk multiplier
From 5 to 15	8%
From 16 to 30	50%
From 31 to 45	70%
46 or more	100%

8. For non-DvP transactions (i.e. free deliveries), after the first contractual payment/delivery leg, the bank that has made the payment will treat its exposure as a loan if the second leg has not been received by the end of the business day³. This means that a bank under the standardized approach will use the standardized risk weights set forth in this Module. However, when exposures are not material, banks may choose to apply a uniform 100% risk-weight to these exposures, in order to avoid the burden of a full credit assessment. If five business days after the second contractual payment/delivery date the second leg has not yet effectively taken place, the bank that has made the first payment leg will risk weight the full amount of the value transferred plus replacement cost, if any at 1,250%. This treatment will apply until the second payment/delivery leg is effectively made.

³ If the dates when two payment legs are made are the same according to the time zones where each payment is made, it is deemed that they are settled on the same day. For example, if a bank in Tokyo transfers Yen on day X (Japan Standard Time) and receives corresponding US Dollar via CHIPS on day X (US Eastern Standard Time), the settlement is deemed to take place on the same value date.