ANNEX II

Conversion methodologies for derivative instruments

1. The following conversion methods shall be applied to the non-exhaustive list below of standard derivatives:

(a) Futures
   - Bond future: Number of contracts * notional contract size * market price of the cheapest-to-deliver reference bond
   - Interest rate future: Number of contracts * notional contract size
   - Currency future: Number of contracts * notional contract size
   - Equity future: Number of contracts * notional contract size * market price of underlying equity share
   - Index futures: Number of contracts * notional contract size * index level

(b) Plain vanilla options (bought/sold puts and calls)
   - Plain vanilla bond option: Notional contract value * market value of underlying reference bond * delta
   - Plain vanilla equity option: Number of contracts * notional contract size * market value of underlying equity share * delta
   - Plain vanilla interest rate option: Notional contract value * delta
   - Plain vanilla currency option: Notional contract value of currency leg(s) * delta
   - Plain vanilla index options: Number of contracts * notional contract size * index level * delta
   - Plain vanilla options on futures: Number of contracts * notional contract size * market value of underlying asset * delta
   - Plain vanilla swaptions: Reference swap commitment conversion amount * delta
   - Warrants and rights: Number of shares/bonds * market value of underlying referenced instrument * delta

(c) Swaps
   - Plain vanilla fixed/floating rate interest rate and inflation swaps: notional contract value
   - Currency swaps: Notional value of currency leg(s)
   - Cross currency interest rate swaps: Notional value of currency leg(s)
   - Basic total return swap: Underlying market value of reference asset(s)
   - Non-basic total return swap: Cumulative underlying market value of both legs of the TRS
   - Single name credit default swap:
     - Protection seller — The higher of the market value of the underlying reference asset or the notional value of the Credit Default Swap.
     - Protection buyer — Market value of the underlying reference asset
   - Contract for differences: Number of shares/bonds * market value of underlying referenced instrument

(d) Forwards
   - FX forward: notional value of currency leg(s)
   - Forward rate agreement: notional value

(e) Leveraged exposure to indices with embedded leverage

A derivative providing leveraged exposure to an underlying index, or indices that embed leveraged exposure to their portfolio, must apply the standard applicable commitment approach to the assets in question.
2. The following conversion methods shall be applied to the non-exhaustive list below of financial instruments which embed derivatives:

- Convertible bonds: Number of referenced shares * market value of underlying referenced shares * delta
- Credit linked notes: Market value of underlying reference asset(s)
- Partly paid securities: Number of shares/bonds * market value of underlying referenced instruments
- Warrants and rights: Number of shares/bonds * market value of underlying referenced instrument * delta

3. List of examples of non-standard derivatives with the related commitment methodology being used:

- Variance swaps: Variance swaps are contracts that allow investors to gain exposure to the variance (squared volatility) of an underlying asset and, in particular, to trade future realised (or historical) volatility against current implied volatility. According to market practice, the strike and the variance notional are expressed in terms of volatility. For the variance notional, this gives:

\[
\text{variance notional} = \frac{\text{vega notional}}{\frac{\text{strike}}{2}}
\]

The vega notional provides a theoretical measure of the profit or loss resulting from a 1 % change in volatility. As realised volatility cannot be less than zero, a long swap position has a known maximum loss. The maximum loss on a short swap is often limited by the inclusion of a cap on volatility. However without a cap, a short swap's potential losses are unlimited.

The conversion methodology to be used for a given contract at time \( t \) is:

\[
\text{Variance notional} \times (\text{current}) \text{ variance}_t \text{ (without volatility cap)}
\]

\[
\text{Variance notional} \times \min \left( (\text{current}) \text{ variance}_t, \text{volatility cap} \right) \text{ (with volatility cap)}
\]

whereby: (current) variance is a function of the squared realised and implied volatility, more precisely:

\[
(\text{current}) \text{ variance}_t = \frac{t}{T} \times \text{realized volatility} (0,t)^2 + \frac{T-t}{T} \times \text{implied volatility} (t,T)^2
\]

- Volatility swaps

By analogy with the variance swaps, the following conversion formulae should be applied to volatility swaps:

\[
\text{Vega notional} \times (\text{current}) \text{ volatility}_t \text{ (without volatility cap)}
\]

\[
\text{Vega notional} \times \min \left( (\text{current}) \text{ volatility}_t, \text{volatility cap} \right) \text{ (with volatility cap)}
\]

whereby the (current) volatility \( t \) is a function of the realised and implied volatility.

4. Barrier (knock-in knock-out) options

Number of contracts * notional contract size * market value of underlying equity share * delta