**Section 330.230 Credit Exposure Arising from Derivative Transactions**

a) Scope. This Section sets forth the standards for calculating the credit exposure arising from a derivative transaction entered into by a state bank for purposes of determining the bank's lending limit pursuant to Section 32 of the Act, Section 6013 of the Savings Bank Act or, as applicable, this Part.

b) Derivative Transactions

1) Non-Credit Derivatives

Subject to subsections (b)(2) and (b)(3), a state bank shall calculate the non-credit derivative exposure (e.g., a contract regarding performance at a point in time unrelated to specific credit risk, such as, but not limited to, interest rates or future delivery, such as forwards, futures, options, caps or floors) to a counterparty arising from a derivative transaction by one of the methods described in this subsection (b)(1). Subject to subsection (b)(3), a state bank shall use the same method for calculating counterparty credit exposure arising from all of its derivative transactions.

Conversion Factor Matrix Method

The credit exposure arising from a derivative transaction under the Conversion Factor Matrix Method shall equal and remain fixed at the potential future credit exposure of the derivative transaction as determined at the execution of the transaction by reference to the following table, which is based on the following formula:

Credit exposure = (notional amount) x (conversion factor)

| Conversion Factor Matrix for Calculating Potential Future Credit Exposure\* | | | | |
| --- | --- | --- | --- | --- |
| Original Maturity\*\* | Interest Rate | Foreign Exchange Rate and Gold | Equity | Other\*\*\*  (includes commodities and precious metals except gold) |
| 1 year or less | .015 | .015 | .20 | .06 |
| Over 1 to 3 years | .03 | .03 | .20 | .18 |
| Over 3 to 5 years | .06 | .06 | .20 | .30 |
| Over 5 to 10 years | .12 | .12 | .20 | .60 |
| Over 10 years | .30 | .30 | .20 | 1.00 |

2) Credit Derivatives

A) A state bank shall calculate the counterparty credit exposure arising from credit derivatives entered by the bank or savings association by adding the net notional value of all protection purchased from the counterparty on each reference entity.

B) A state bank shall calculate the credit exposure to a reference entity arising from credit derivatives entered by the bank by adding the notional value of all protection sold on the reference entity. However, the bank may reduce its exposure to a reference entity by the amount of any eligible credit derivative purchased on that reference entity from an eligible protection provider.

3) Mandatory Use of a Certain Method

A) Upon request by a state bank, the Department may allow a state bank to use any method the Department deems appropriate to calculate the credit exposure of derivative transactions if the Department finds that the method is necessary to promote the safety and soundness of the bank.

B) A state bank may elect to determine credit exposure on the basis of such other method of determining credit exposure as may be permitted by 12 CFR 32.9 (June 12, 2012) for national banks by the Office of the Comptroller of Currency.

\* For an OTC derivative contract with multiple exchanges of principal, the conversion factor is multiplied by the number of remaining payments in the derivative contract.

\*\* For an OTC derivative contract that is structured so that, on specified dates, any outstanding exposure is settled and the terms are reset so that the market value of the contract is zero, the remaining maturity equals the time until the next reset date. For an interest rate derivative contract with a remaining maturity of greater than one year that meets these criteria, the minimum conversion factor is 0.005.

\*\*\* Transactions not explicitly covered by any other column in the Table are to be treated as "Other".

(Source: Added at 37 Ill. Reg. 5807, effective April 22, 2013)