APPENDIX C

PAYMENT NETTING - PIERCING THE UNIT OF ACCOUNT

Assume Counterparty A has executed two interest rate swap contracts with Counterparty B. The scheduled payments and related fair values for both swaps at the measurement date are as follows. Amounts shown in PMT columns are net cash receipts (cash payments) for each swap at each payment date.

	Total fair value asset (liability)	PMT 1	PMT 2	PMT 3	PMT 4	PMT 5	PMT 6
Swap A	**50**	(20)	(10)	35	25	15	5
Swap B	**(40)**	(35)		(15)		10	
Subtotals	*10*	*(55)*	*(10)*	*20*	*25*	*25*	*5*

Following are examples of how payment netting might be interpreted in practice:

Method 1: Net payments by specific payment date where offset of cash flows occur (PMT 3 only)

	Total fair value asset (liability)	PMT 3	**Balance sheet asset (liability)**
Swap A	50	(15)	**35**
Swap B	(40)	15	**(25)**

Method 2 – Identify all dates where payments match and separately record amounts

Payment dates that match				Remaining payments under SWAP A			
PMT 1	PMT 3	PMT 5	**Balance sheet liability**	PMT 2	PMT 4	PMT 6	**Balance sheet asset**
(20)	35	15		(10)	25	5	
(35)	(15)	10					
(55)	*20*	*25*	**(10)**	*(10)*	*25*	*5*	**20**

Method 3 - Identify all positive and negative cash flows, including any net cash flows on the same payment dates.

Positive cash flows				Negative cash flows		**Balance sheet asset (liability)**
PMT 3	PMT 4	PMT 5	PMT 6	PMT 1	PMT 2	
35	25	15	5	(20)	(10)	

(15)		10		(35)		
20	**25**	**25**	**5**			**75**
				(55)	**(10)**	**(65)**

NOTE:

As a result in the potential diversity in practice and the operational difficulties seen in piercing the unit of account, the suggested treatment of the above contracts by some constituents, depending on the criteria, would be either to show a net 10 (net the entire fair values) or gross asset of 50 and a gross liability of (40) on the balance sheet (prohibit netting of the entire amounts).