

2003-02-03

**TO ALL BANKS, BRANCHES OF FOREIGN BANKS AND MUTUAL BANKS**  
**BANKS ACT CIRCULAR 3/2003**  
**POSITIONS DENOMINATED IN FOREIGN CURRENCY HELD BY BANKS**

**EXECUTIVE SUMMARY**

The risk inherent in foreign-exchange business was emphasised in recent years by the volatility in exchange rates. Consequently, the monitoring of currency risk has become a matter of increased interest to regulators.

When a bank has net open positions in foreign currencies, including gold, the bank is exposed to currency risk, irrespective of whether the position is held in the bank's banking book or trading book.

It is important for a bank to include all foreign-currency assets (except infrastructural investments) and liabilities, as well as all commitments to purchase or sell foreign currency, in respect of the banking and trading activities of the reporting bank and its foreign operations, after all book entries have been effected, when the bank calculates its aggregate effective net open foreign-currency position.

Investment and trading positions in authorised instruments denominated in foreign currency held by banks are progressively increasing over time. Furthermore, the current arrangement for the reporting of foreign-currency assets and liabilities complicates the distinction between loans and advances denominated in foreign currency on the one hand and investment and trading positions denominated in foreign currency on the other. Therefore, a new arrangement is necessary.

## 1. INTRODUCTION

Banking entails, amongst other things, the management of a series of risk. These risks can take various forms, and the extent and complexity of each risk area differ from bank to bank.

One of the risks that a bank may incur is currency risk, that is, the risk of loss resulting from a change in the price of the bank's foreign-currency positions.

In terms of the Exchange Control Regulations, a bank that wishes to deal in foreign exchange in South Africa may be appointed by the National Treasury as an authorised dealer in foreign exchange. Authorised dealers are allowed to act as principals in the foreign-exchange market, that is, they can act in their own names and may establish positions in foreign exchange.

Although the South African Reserve Bank ("SARB") does not place a restriction on the amount of foreign currency that an authorised dealer may hold in its own name, the authorised dealer is subject to certain restrictions on the purpose and placement of the funds and on the bank's effective net open position.

The foreign-currency holdings of an authorised dealer may be retained solely to facilitate the execution, settlement or hedging of foreign-exchange transactions or the hedging of foreign-exchange and interest-rate exposures, in accordance with current Exchange Control requirements or in terms of specific approval granted by the Exchange Control Department of the SARB, either for the authorised dealer's own account, or on behalf of its clients.

Furthermore, in terms of conditions imposed by the SARB, the placement of a bank's foreign-currency holdings has to be in the name of the authorised dealer and is restricted to the following assets:

- (a) Funds placed with non-resident banks.
- (b) Funds invested in tradeable non-resident assets, such as:
  - (i) Bonds and bills issued or guaranteed by governments.
  - (ii) Money-market instruments issued by, or guaranteed by, non-resident banks.
  - (iii) Commercial paper.
- (c) Funds placed in margin accounts for exchange-traded instruments.
- (d) Funds placed in margin accounts in terms of credit-support agreements.

Currently, Exchange Control restrictions apply in respect of the purchase of the following assets:

- (a) Equity investments.
- (b) Any instrument that earns a dividend.
- (c) Infrastructural investments.
- (d) Subordinated debt.
- (e) Any investment of a capital nature.
- (f) Instruments issued by South African residents that are listed on foreign exchanges or that are denominated in foreign currency.

## **2. RISK INHERENT IN FOREIGN-EXCHANGE BUSINESS**

The risk inherent in foreign-exchange business was emphasised in recent years by the volatility in exchange rates. Consequently, the monitoring of currency risk has become a matter of increased interest to regulators. Regulators, for example, monitor the nature and extent of banks' foreign-currency positions in order to ensure that foreign-exchange positions are never so large as to constitute a significant threat either to the solvency and liquidity of an individual bank, or to the stability of the banking system as a whole.

## **3. CURRENT REGULATORY FRAMEWORK**

In terms of the provisions of the Regulations relating to Banks, banks have to include the following in the form DI 600 in respect of the banking and trading activities of the reporting bank and its foreign operations, after all book entries have been effected:

- (a) Foreign-currency assets (except infrastructural investments) and liabilities.
- (b) Commitments to purchase or sell foreign currency.

Line item 1 of the form DI 600 has to be equal to the aggregate amount of line items 45 and 57 of the form DI 100. Therefore, banks are including all assets repayable in foreign currency, except gold coin and bullion, non-RSA-currency cash holdings and infrastructural investments in line item 57 of the form DI 100. The latter arrangement means that when the following are repayable in foreign currency, they are being reported in line item 57 of the form DI 100:

- (a) All loans and advances.

- (b) Funds placed with residents and non-residents.
- (c) Funds invested in authorised instruments.

Investment and trading positions in authorised instruments denominated in foreign currency held by banks are progressively increasing over time. Furthermore, the aforementioned arrangement complicates the distinction between loans and advances denominated in foreign currency on the one hand and investment and trading positions denominated in foreign currency on the other. Therefore, a new arrangement is necessary.

#### **4. DECISION TO AMEND THE REGULATIONS RELATING TO BANKS**

When a bank has net open positions in foreign currencies, including gold, the bank is exposed to currency risk, irrespective of whether the position is held in the bank's banking book or trading book.

It is therefore important for a bank to include all foreign-currency assets (except infrastructural investments) and liabilities, as well as all commitments to purchase or sell foreign currency, in respect of the banking and trading activities of the reporting bank and its foreign operations, after all book entries have been effected, when the bank calculates its aggregate effective net open foreign-currency position.

In order to distinguish between the various asset classes that may be denominated in foreign currency, banks are hereby requested to report the respective asset classes as follows:

- (a) Gold coin and bullion and non-RSA-currency cash holdings in line item 45 of the form DI 100.
- (b) Loans and advances denominated in foreign currency in line item 57 of the form DI 100.
- (c) Investment and trading positions denominated in foreign currency in line items 64 to 70 of the form DI 100, in accordance with the respective asset items specified in the said line items.

The aforementioned arrangement shall apply in respect of the reporting periods from April 2003.

For the reasons explained above, all foreign-currency assets, except infrastructural investments and investments in foreign branches and subsidiaries that are fully deducted from the reporting bank's capital and reserve funds, have to be included in the calculation of a bank's aggregate effective net open foreign-currency position. Banks, therefore, have to continue to include the aforementioned assets in line item 1 of the form DI 600.

All on-balance-sheet liabilities denominated in foreign currency, including liability positions arising from transactions in derivative instruments, have to be reflected against the appropriate liability items specified in the form DI 100 and have to be included in line item 15 of the form DI 600.

**5. FUTURE AMENDMENT TO THE REGULATIONS RELATING TO BANKS**

Notice is hereby given that this Office is in the process of drafting amendments to the Regulations relating to Banks in order to incorporate the provisions of this circular.

**6. ACKNOWLEDGEMENT OF RECEIPT**

Two additional copies of this circular are enclosed for the use of your institution's independent auditors. The attached acknowledgement of receipt, duly completed and signed by both the chief executive officer of the institution and the said auditors, should be returned to this Office at the earliest convenience of the aforementioned signatories.

C F Wiese  
**Registrar of Banks**

The previous circular issued was Banks Act Circular 2/2003 dated 31 January 2003.