2004-12-10

TO ALL BANKS, BRANCHES OF FOREIGN BANKS AND MUTUAL BANKS

BANKS ACT CIRCULAR 18/2004

TREATMENT OF REGULATORY CAPITAL - RISK MARGIN PLACED WITH LICENCED EXCHANGES

1. INTRODUCTION

The purpose of risk margin is to protect the members of an exchange from market fluctuations when they trade in futures and options on an exchange. Each instrument has a precalculated initial margin, which is prefunded, and a variation margin which is paid or received on a daily basis, depending on the price fluctuation of the underlying derivative instrument.

Initial margin means the amount of money determined by a clearing house on the basis specified by the particular exchange and held in respect of the aggregate position of a derivative member or a client.

Variation margin means the amount paid to or by a derivative member or client in whose name a position in an exchange contract is registered as a result of the marking to market of a position, as defined in the clearing house rules or the closing out of a position or part thereof.

2. CURRENT TREATMENT

The DI 400 return (Capital Adequacy) prescribes that all risk margin placed with either a formal or an over-the-counter ("OTC") exchange be impaired against capital. The purpose of this requirement is to comply with the requirements set by the Basel Committee on Banking Supervision ("Basel Committee") insofar that so-called double-gearing of capital should not result, as this would increase systemic risk within a banking system. The Basel Committee, however, has agreed that individual supervisory authorities have the discretion to apply either an impairment, or a risk weighting of 100 per cent on such holdings.

3. PROPOSED TREATEMENT

After due consideration of the above matter, this Office wishes to advise that the future treatment of risk margin as it pertains to capital adequacy purposes will be as follows:

3.1 Risk margin in respect of exchange traded transactions are to be reported under line item 84 (Other assets) in the DI 100 return (Balance Sheet) and risk weighted at 100 per cent; and

3.2 risk margin in respect of OTC traded transactions are to be reported under line item 72 (Risk-margin requirements of any formal or OTC market) of the DI 400 return and therefore impaired against capital.

4. 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.

E M Kruger
Registrar of Banks

The previous circular issued was Banks Act Circular 17/2004 dated 29 October 2004.