FOREIGN CURRENCY EXPOSURE RETURN

A *Guidance Notes*

1. Application and frequency of returns

The return should be completed on an unconsolidated basis as at the end of March, June, September and December each year by institutions licensed under the Banks and Deposit Companies Act 1999.

The return should be completed to show the equivalent values in BD$ (000s) of all currency and gold assets and liabilities, and of the contracted foreign currency and gold amounts of all forward transactions and of all currency and gold futures transactions. Positive or (in brackets) negative entries should be made as indicated by the column headings, or by the following notes.

B *Notes for completion of Section 1*

2. Arithmetic relationships

Please ensure that the following relationships hold for the completed return, taking into account that figures in brackets are negative:

(i) for each row, column 1 less column 2 equals column 3;
(ii) for each row, the sum of columns 3 to 6 equals column 7;
(iii) the aggregate of the net short open positions, in column 7, should equal the sum of all the bracketed (i.e. negative) figures in the column.

3. Column 1
Gross spot claims

Enter in column 1 all gross spot claims (i.e. gross of all provisions for bad and doubtful debts) in foreign currencies, gold bullion and gold coin. All the entries should be positive.

Asset interest accruals should not be included. Unmatured spot deals should not be entered here but must be entered in column 4.

4. Column 2
Gross spot liabilities, including internal accounts

Enter in column 2 all gross spot liabilities, including internal accounts, in foreign currencies, gold bullion and gold coin. **Entries in the currency rows of this column should not be in brackets,** except where gross spot assets arise because of the inclusion of internal accounts.

Unmatured spot deals should not be entered here but must be entered in column 4.

5. Column 3
Net spot claims (liabilities) including internal accounts

The entries in column 3 equal the entries in column 1 less those in column 2.

6. Column 4
Net forward purchases (sales)

Enter in column 4 net forward purchases and sales of foreign currency, gold bullion, gold coin, including positions with overseas offices of the reporting institution, and unmatured spot deals. If one side of the transaction is denominated in BD$ then the BD$ amount of the BD$ side of the contract should not be entered in this column. Include purchases and sales of futures contracts in currency and gold, known net future income (expense) not already included in column 3, adjusted options positions (i.e. the delta values), profit & loss and specific provision accounts denominated in foreign currencies and disaggregation of net positions in composite currencies into component currencies (to enable hedges in the underlying currencies).

For **cross currency interest swaps** enter the forward re-exchange of principal in column 4 if its exclusion would lead to a false position being reported. A false position would be reported if a bank took a deposit in one currency, swapped the funds into another currency, under a cross currency interest rate swap, and then made a loan in the second currency.

The net forward position should be translated into BD$ at prevailing spot exchange rates, unless it has been agreed with the Bermuda Monetary Authority (the Authority) that forwards may be reported on a net present value basis (see below).

The net flow arising as a result of repo (stock lending) or reverse repo (stock borrowing) transactions should also be reported in this column.

7. Column 5
Known Net Future income (expense) not included already in column 3

Enter in column 5 the net flow of interest payable and receivable on deposits and loans arising from swap arbitrage transactions (i.e. transactions undertaken to take advantage of the fact that interest rates prevailing in the money market are out of line with those implied by forward foreign exchange rates) that are not included in column 3. All such flows should be reported in this column, irrespective of being hedged by spot or forward market transactions.
These interest flows are included in column 5 because the forward foreign exchange deal, which is part of the overall arbitrage transaction, normally incorporates an element for interest due/payable on the deposit/loan, whereas the spot foreign exchange transaction does not. Were the interest flows not to be reported in column 5 an artificially large

position would be reported in column 7 (because the nominal amounts under the forward transaction will be larger than the nominal amounts under the spot transaction). If the forward foreign exchange transaction does not fully incorporate the interest due/payable then the interest should still be reported, since the institution would be deliberately taking an open position.

Do not include other unhedged interest flows, but do include all hedged net flows, both of interest and of other income and expense, apart from those which have been accrued onto the balance sheet and are therefore included in column 3. The reporting of interest (and other income and expense) is necessary in order to net out the hedge transactions. Such hedges could take the form of forward sales of the interest due (in the future) on a fixed rate currency loan, in which case it would be reported in column 4. If the future in-flow of interest were not reported the forward transaction would create an apparent position.

Reporting institutions wishing to take up discounting forward position by the relevant currency interest rate for the relevant period must obtain the written agreement of DTD.

8. Column 6
Net long (short) position of overseas branches

Column 6 must be completed by Bermuda incorporated institutions that have overseas branches which deal in foreign exchange. The total net position in each currency of all overseas branches listed in Section 2 of the report should be entered in this column.

9. Column 7
Net overall long (short) position

Enter in column 7 the net overall position in each currency and in the aggregate of foreign currencies not separately specified.

The **BD$ balancing item** is the figure that is required so that the total of the overall net long and net short positions, in all currencies taken together, equals zero. It must be equal and opposite to the sum of the entries in the boxes above it.

If branches of overseas institutions consider that the adoption of a BD$ balancing item results in a misstatement of their currency exposure, further reference should be made to the Authority.

10. Column 8
Optional adjustments for structural position

Reporting institutions may enter in column 8 any currency item that the Authority has agreed is structural.

Once a position has been defined as structural it must be reported consistently in column 8 even if this increases the net short open position.

Reporting institutions must attach a separate schedule to their S3 Form setting out the items that have been included in column 8 in both their currency amounts and equivalent values in Bermuda dollars.

Prior reference to the Authority is required before any item may be regarded as structural, other than the following:

Premises
Fixtures and fittings (including plant and equipment)
Investments in subsidiaries [1]
Investments in associates

11. Column 9
Net dealing long (short) position

Column 9 shows the dealing position in each currency, against which the guidelines agreed with the Authority apply. It should be calculated by **subtracting** column 8 from column 7.

Enter in column 9 the net overall position in each currency. Currencies not individually specified should be divided into net long positions (positive figure) and net short positions (negative figure in brackets), and these two positions should be entered in the two boxes provided. The sum of these two figures should equal the sum of the corresponding entries in column 7, less any entry in column 8.

The entries under **Bermuda dollar balancing item** and the **aggregate of net short open positions** should be calculated in the same way as for column 7.

The **aggregate of net short open positions** is the sum of all net short (i.e. bracketed) positions in the rows for individually specified currencies, the entry for currencies not individually specified and, if negative, the BD$ balancing item. For

[1] Including the provision of working capital to fund structural assets in an overseas operations.

all licensed institutions this aggregate will be reported at item 540 of the Capital Adequacy Return and hence included in the Risk Asset Ratio.

C *Notes for completion of Section 2*

12.
Section 2 should be completed by licensed institutions which have overseas branches dealing in foreign exchange. The entries should show the individual branch's or dealing

centre's net position in each currency on the same basis as Section 1 columns 1-5 inclusive. Positions held in the currency of the country in which the branch is located and positions arising from transactions with other branches or the headquarters of the bank should be included.

Returns are not required in respect of branches or dealing centres which have an aggregate position, taking all currencies together regardless of sign, of less than ½% of the adjusted capital base of the reporting institution.

Reference should be made to the Authority, in the event of any difficulties with this treatment, or if any branch maintains a position that is regarded as structural.