
**FOREIGN CURRENCY ACCOUNTS OF AUTHORIZED DEALERS AND
PURCHASE AND SALE OF FOREIGN CURRENCIES**

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CHAPTER 5

FOREIGN CURRENCY ACCOUNTS OF AUTHORIZED DEALERS AND PURCHASE AND SALE OF FOREIGN CURRENCIES

1. Introduction.

This chapter sets out the regulations governing purchase and sale of foreign currencies by Authorized Dealers in the inter-bank market in Pakistan as well as their purchase from and sale to the State Bank and overseas branches and correspondents.

2. Accounts in Foreign Currencies.

Authorized Dealers are permitted to open and maintain accounts in all fully convertible currencies with their branches and correspondents abroad, subject to the condition that opening of every new account should be reported to the Director, Exchange Policy Department by a letter giving the name and address of the foreign branch or correspondent with whom the account has been opened and the currency of the account.

3. Foreign Currency held at the disposal of the State Bank.

Foreign currency balances of Authorized Dealers, whether operated by their Head/Principal Offices or branch offices, shall at all times be held at the disposal of the State Bank which may give such directions for their disposal as it may consider necessary and expedient. The State Bank may direct Authorized Dealers at any time to sell either ready or for forward delivery, foreign currency or currencies held by them to the State Bank or to such other person or persons as the State Bank may direct.

4. Exposure Limits and Nostro Limits.

i) The State Bank fixes from time to time limits for foreign exchange exposure on an overall basis for all currencies for each bank authorized to deal in foreign exchange. These limits are intended to cover the positions of all the branches in Pakistan of banks incorporated abroad, and all the branches, including overseas branches, if any, of banks incorporated in Pakistan. Head/Principal Offices of Authorized Dealers should ensure on day to day basis that these limits are not exceeded. It is advisable that Authorized Dealers maintain square or near square exposure.

ii) There are no Nostro Limits for balances held abroad.

5. Calculation of Exposure Limits.

The guidelines for calculating the exposure are available in Appendix VI-1.

6. Exchange Exposure Position.

Authorized Dealers are required to report to the Domestic Markets and Monetary Management Department, State Bank of Pakistan, on daily basis all the foreign exchange transactions (ready, forward, take-ups, cancellation and adjusting entries etc.) undertaken by them with counterparties that create foreign exchange exposure in any currency. This data is to

be reported using the software available at following URL (<http://www.sbp.org.pk/dmmd/Software.htm>)

E-mails, containing following database files generated by the software, are required to be submitted on daily basis to the Domestic Markets and Monetary Management Department, by 9:30 am at following address (fxcrs@sbp.org.pk):

- a) Deals
- b) Take-ups
- c) Cancelled deals
- d) Adjusting entries
- e) Closing balance
- f) Currency wise Nostro balances
- g) FE-25 Financing

7. Purchase and sale of Foreign Currencies.

Authorized Dealers may freely purchase foreign currencies, as there are no restrictions on inward remittances. All sales of foreign currencies to customers must, however, be in cover of genuine transactions approved by the State Bank or by the Authorized Dealers under powers delegated to them.

8. Inter-bank transactions.

Authorized Dealers may freely buy and sell foreign currencies from and to other Authorized Dealers in Pakistan provided they remain within their permissible exposure limit.

9. Purchase of U.S. Dollars from and their sale to the Authorized Dealers by the State Bank.

The State Bank may, at its discretion, buy U.S. dollars from and sell to the Authorized Dealers both ready and forward.

10. Purchase and sale of Foreign Currency from and to Banks' Overseas Branches and Correspondents.

Authorized Dealers may freely purchase both ready and forward one foreign currency against another from their overseas branches and correspondents in order to cover their positions. Purchase of foreign currencies from and their sale to banks' overseas branches and correspondents against Rupee may be made in accordance with the provisions of Chapter 7.

Guidelines for calculation of open positions and establishing position limits

It has been decided to revise, with effect from end-September, 1998, the method of calculating the open position and establishing position limits. The overall position limit/foreign exchange exposure limit (FEEL) will be fixed as 20 percent of the audited paid-up-capital (free of losses) in Pakistan of each Authorized Dealer with a maximum cap of PKR 3,500 million. However, State Bank reserves the right to assign the FEEL of any Authorized Dealer below 20% of Paid-up Capital (free of losses), based on the trends observed in the utilization of FEEL.

The open position must first be measured separately for each foreign currency in which the bank is performing transactions or has assets or liabilities. The open position in a single currency is the sum of (a) the spot position and (b) the off-balance sheet position. Details of its calculation are provided in the Annexure. The net position in each currency is calculated by adding together the net spot position and net off-balance sheet position for each currency separately. For example, a spot deposit liability (FCA account) matched by an SBP forward contract (an off-balance sheet asset) would translate to a zero net open foreign exchange position.

Once the exposure has been determined in each individual currency, the second step is to measure the bank's overall exposure to foreign exchange risk.

- Conversion of the net position in each currency into the equivalent amount of domestic currency by using Ready exchange rates(as provided by State Bank for mark to market);
- Aggregation of the domestic currency equivalent values of all foreign currency short positions and of all foreign currency long positions;
- Comparison of the two totals, and selection of the greater of the two, which is defined as the overall exposure of the bank.

An example of how this method can be applied is provided in the Annexure.

ANNEXURE: FOREIGN CURRENCY EXPOSURE REGULATION, MONITORING AND REPORTING FOR COMMERCIAL BANKS

This annexure provides a framework for foreign currency exposure regulation, monitoring and reporting for commercial banks. It contains the following sections:

- Regulations for the exposure limits that commercial banks have to observe, a sample calculation of exposure.

A. Foreign Exchange Risk Exposure

- a. Limit to the overall foreign exchange risk exposure.

(1) The overall foreign exchange risk position as at close of business each day of any commercial bank shall not exceed FEEL assigned by State Bank of Pakistan to the bank.

(2) In addition, each depository institution shall maintain its intraday overall foreign exchange risk position within prudent boundaries.

b. The overall foreign exchange risk exposure is the sum of the equivalent amount in domestic currency of all net short or long positions (whichever is greater) in currencies in which the commercial bank has positions.

c. In calculating, foreign currency exposure in each single currency is defined as the domestic currency equivalent sum, currency by currency, of all foreign currency-denominated assets and liabilities. No foreign currency-denominated assets or liabilities can be deleted, unless it has been explicitly agreed with the supervisory authorities not to include that item (structural positions). Furthermore, the calculation shall include also the net forward (off-balance sheet) position in each currency.

Definitions of spot position and off-balance sheet (forward) position.

The spot position in a currency is the difference between assets and liabilities denominated in that currency, as they appear in the balance sheet. In particular, this includes accrued income and expenses: interest on loans and interbank borrowing and other income earned but not yet received, and interest due to depositors, and interbank providers of funds and administrative expenses not yet paid, as they appear in the relevant accounts of a bank applying the accrual principle.

According to this principle, unearned future interest and expenses should not be included in the position, since they are not yet recorded in the books. For instance, a bank borrows in foreign currency on the interbank market for one year, with all interest payable at the end. The principal amount is of course included in the position as soon as it is received. The appropriate amount of accrued interest is booked at the end of each month in the account tracing interest due but not yet paid. Therefore, interest is included in the position in monthly tranches.

However, since banks should know exactly how much interest they will have to pay at the end of the year, some banks find it more prudent to hedge the total amount of interest immediately. To hedge these interest payments without creating an artificial position, they need to include this interest in the position, even before it has been booked. Such a procedure, based on a prudent approach, should be considered as acceptable, provided that it is fully documented and applied by the bank in a consistent way.

Structural positions, like long-term participation in the capital of other banks and enterprises, are usually also deducted from the spot position.

Off-balance sheet items include all foreign currency-denominated assets and liabilities not included in the balance sheet. These transactions are recorded in the off-balance sheet section of the bank's books. Among these, forward transactions are typically the most common. The forward position includes all amounts to be received less all amounts to be paid at a future value date as a result of foreign exchange transactions which have already taken place.

Off-balance sheet items include:

- Spot foreign exchange transactions which have not yet been settled. When the day's deal is done, banks must record the amount to be received of the bought currency and the amount of the sold currency to be delivered in specific off-balance sheet accounts. When the deal is actually settled (usually two working days later), the off-balance sheet accounts are purged and the relevant accounts of the balance sheet incremented.
- Forward foreign exchange transactions. A procedure identical to the one for outstanding spot transactions should be used, with the difference that the delay between transaction and settlement dates will be longer. However, following the recommendation of the Basle Committee and in order to clearly separate the interest rate risk from the foreign exchange risk, the position should be valued by using the ready exchange rate rather than the forward rate.
- Guarantees and similar commitments denominated in foreign currencies, but only if they are certain to be called upon and are likely to be irrecoverable.

Other principles.

a. For the purpose of this regulation, the same definition of "paid-up-capital (free of losses)" will be used as currently used at the SBP in its Prudential Regulations.

b. The following other principles shall be applied:

(1) No undervaluation shall take place; assets are to be marked to market.

(2) Accrued interest is to be included, wherever applicable.

(3) Balance sheet and off-balance sheet (forwards etc.) exposures are reported separately but added together to arrive at overall exposure.

c. Besides the specific limitations, commercial banks should be required to set up an internal system for:

(1) The immediate entry of foreign exchange operations, the continuous measurement of positions and their results;

(2) The monitoring of the risks, the implementation of internal limits and the designation of a high-ranking officer in charge of clearly defined responsibilities.

B. Sample Calculation of Foreign Exchange Risk Exposure

This section provides an example of how to calculate the actual outstandings related to the limit of the overall foreign exchange risk exposure with the following foreign exchange positions:

1. Positions (- sign indicates a short position)

Currency	Balance Sheet Position	Forward Position	Total
USD	500	-800	-300
AUD	500	-200	300
SEK	-1,000	1,600	600
AED	200	---	200

THB	3,000	-800	2,200
HKD	-1,900	300	-1,600
JPY	200	700	900

a. To compute the outstanding exposures in relation to the limits, identify the currently ready foreign exchange rates as provided by State Bank for mark to market (hypothetical example) for each of the currencies in which a position does exist:

Currency	Ready Mark to Market Exchange Rate
USD	101.7671
AUD	77.918
SEK	11.8436
AED	27.7061
THB	3.1008
HKD	13.1052
JPY	0.8400

b. Compute the local currency equivalent of the spot and forward positions in foreign currencies, by currency:

Currency	Balance Sheet		Forward		Total	
	Long	Short	Long	Short	Long	Short
USD	50,884	-	-	-81,414		-30,530
AUD	38,959			-15,584	23,375	
SEK		-11,844	18,950		7,106	
AED	5,541				5,541	
THB	9,302			-2,481	6,821	
HKD		-24,900	3,932			-20,968
JPY	168		588		756	
Local Currency					7899	
Total	104,854	-36,744	23,470	-99,479	51,498	-51,498
Net	68,110			-76,009		
Overall against domestic currency						7,899

c. Sum up the local currency equivalent of all short and long foreign currency positions. The foreign currency position, overall, is 7,899 short, i.e. the domestic currency position is 7,899 long. The sum of all long (short) positions is 51,498 (-51,498).

Compare this figure with the assigned FEEL.

2. Reporting.

Foreign currency exposures have to be available to the treasury management functions in a commercial bank at all times. The exposure ratios by currency can be reported on a daily/weekly/monthly basis to the supervisory authorities, as required and as the reporting capabilities of the banks improve.

However, banks have to report on a daily basis summary statistics on their exposures, together with information on their transactions between foreign currencies and the domestic currency by counterpart. The amounts to be reported are the domestic currency equivalents of the transactions. The transactions are for the spot date, not the value date.