

FOREIGN CURRENCY EXPOSURE LIMITS



BANK OF PAPUA NEW GUINEA

PRUDENTIAL STANDARD

2/2001

FOREIGN CURRENCY EXPOSURE LIMITS

Arrangement of Paragraphs

PART I

Preliminary

PARAGRAPH

1. Authorization
2. Application
3. Definitions

PART II

Statement of Policy

PARAGRAPH

1. Purpose
2. Scope
3. Responsibility

PART III

Implementation and Prudential Requirements

PARAGRAPH

1. Limit on Overall Foreign Exchange Risk Exposure
2. Limit on Single Currency Foreign Exchange Risk Exposure
3. Limit on Intra Day Foreign Exchange Risk Exposure
4. Global Limits
5. Exemptions
6. Computation of Foreign Exchange Risk Exposure
7. Correction of Excess Foreign Exchange Risk Exposure
8. Maintenance of Supporting Documentation
9. Reports to Bank of Papua New Guinea

PART IV

Corrective Measures

PARAGRAPH

1. Remedial Measures and Sanctions

PART V

Effective Date

PARAGRAPH

1. Effective Date
2. Supersedence

FOREIGN CURRENCY EXPOSURE LIMITS

PART I: PRELIMINARY

1. **Authorization** - The Bank of Papua New Guinea (“BPNG”) is authorized to issue prudential standards under Section 27 of the Banks and Financial Institutions Act ("Act") in relation to prudential matters to be complied with by all Authorized Institutions.
2. **Application** - All banking and financial institutions licensed by the BPNG to conduct foreign exchange transactions in Papua New Guinea.
3. **Definitions** - Terms used within this prudential standard are as defined below, or as reasonably implied by contextual usage.
 - a. **"bank"** - means all banks and other licensed financial institutions authorised under the Act to engage in foreign exchange transactions.
 - b. **“capital base”** - means “Total Capital” or “Net Capital” as the terms are used in Prudential Standard 1/2000, Capital Adequacy.
 - c. **“foreign currency exposure”** - means the domestic currency equivalent sum, currency by currency, of all net foreign currency denominated assets or liabilities, whether on or off-balance sheet, unless prior permission has been given, in writing, by the BPNG for exclusion.
 - d. **“intra-day foreign exchange risk exposure”** - means the foreign exchange risk exposure, in either a single currency or as the sum of all currencies, which a bank incurs between the opening and close of business on the same day.
 - e. **“overall foreign currency exchange risk exposure”** - means the sum of all net on-balance sheet and off-balance sheet assets or liabilities denominated in foreign currencies, expressed as a domestic currency equivalent amount at the spot mid-rate and using the shorthand method for measurement.
 - f. **“single currency exchange risk exposure”** - as measured using the shorthand method, means the the larger of a long position (assets) or short position (liabilities), both on and off-balance sheet, denominated in a single foreign currency and expressed as a domestic currency equivalent amount at the spot mid-rate.
 - g. **“shorthand method”** - means the procedure for measuring the overall foreign exchange risk exposure by: (1) adding separately all short positions on one side and all long positions on the other side; (2) comparing the two totals; and (3) taking the larger of the two totals as the overall open position.
 - h. **“spot mid-rate”** - means that rate, expressed as a factor of the domestic currency equivalent, at which a foreign currency is converted to a domestic currency equivalent.

FOREIGN CURRENCY EXPOSURE LIMITS

PART II: STATEMENT OF POLICY

1. **Purpose** - This prudential standard is intended to: 1) assure that the potential risk of loss to a bank's capital base is within prudential limits; 2) promote maximum availability of foreign exchange at competitive rates; and 3) allow banks to conduct business in a profitable yet prudent manner.
2. **Scope** - This prudential standard applies to all foreign currency-denominated assets and liabilities held by a bank, whether on-balance sheet or off-balance sheet.
3. **Responsibility** - It shall be the responsibility of the board of directors of each bank to establish a system for monitoring and managing its foreign currency exposures prudently and in compliance with the limits set forth in this prudential standard.

PART III: IMPLEMENTATION AND SPECIFIC REQUIREMENTS

1. **Limit on "overall" foreign exchange risk exposure** - The overall foreign exchange risk exposure (short and long currency positions) both on-balance sheet and off-balance sheet, as measured using spot mid-rates and the shorthand method shall not exceed **15%** of a bank's capital base.
2. **Limit on "single" currency foreign exchange risk exposure** - the foreign exchange risk exposure in any single currency, irrespective of short or long position, shall not exceed **10%** of a bank's capital base.
3. **Limit on "intra-day" foreign exchange risk exposure** - intra-day foreign exchange risk exposures, both in single currencies and overall, shall be monitored and maintained within prudent limits as established by a bank's board of directors in a written policy covering foreign exchange risk exposure.
4. **Global limits** - The single currency and overall foreign exchange risk exposure limits indicated above shall apply on a "global" basis, i.e., a bank may have different internal limits for its various branches and operating subsidiaries; however, the limits set forth in this prudential standard apply on a global basis to the bank as a single, consolidated entity.
5. **Exemptions** - If, in the normal course of business, a bank anticipates that it will exceed either the single currency or the overall limit, or if either limit is exceeded due to circumstances beyond the bank's reasonable ability to anticipate and control, then the bank may apply, in writing, to the BPNG for a temporary exemption stating the reason therefor and indicating how and when the excess position will be corrected.
6. **Calculation of foreign exchange risk exposures** - Each bank shall calculate its single currency and overall foreign exchange risk exposures daily using the methodology required by the BPNG.

FOREIGN CURRENCY EXPOSURE LIMITS

7. **Correction of excess foreign exchange risk exposures** - Each bank shall take every reasonable action to immediately correct any and all foreign exchange risk exposures which exceed the limits set forth in this prudential standard and in its board-adopted policy. Failure to correct any non-complying risk exposure, other than one which has been exempted under paragraph 5 above, by the close of business on the following day may result in the imposition of conditions on a bank's license as set forth below.
8. **Maintenance of supporting documentation** - Each bank shall maintain records which are sufficient to determine at all times its single currency and overall foreign exchange risk exposures. Each bank shall also maintain a daily record showing close-of-business foreign exchange risk exposures (both single currencies and overall) and a reconciliation of opening-to-closing positions.
9. **Reports to BPNG** - Each bank shall submit to the BPNG Foreign Exchange Exposure returns and other periodic reports, in the prescribed formats and at intervals as may be required, showing the amounts of foreign exchange risk exposures for both single currencies and for all currencies overall.

PART IV: CORRECTIVE MEASURES

1. **Remedial measures and sanctions** - If a bank breaches any provision of this prudential standard in a flagrant manner which results, or threatens to result, in an unsafe or unsound condition or fails to comply with the instructions and reporting requirements, the BPNG may pursue appropriate corrective actions and sanctions by imposing conditions, or varying conditions, on the bank's license as provided for in Section 14 of the Act.

Such conditions imposed under this Section 14 on a bank's license may include, but not necessarily be limited to, the following:

- a) Require the bank to take certain steps or to refrain from adopting or pursuing a particular course of action or to restrict the scope of its business in a particular way, including a prohibition from engaging in any further foreign exchange activities for a specified period of time;
- b) Impose limitations on the acceptance of deposits, the borrowing of money, the granting of credit or the making of investments;
- c) Prohibit the bank from soliciting deposits, either generally or from persons who are not already depositors;
- d) Prohibit the bank from entering into any other transaction or class of transactions;
- e) Suspend access to BPNG credit facilities;
- f) Require the removal of any directors, managers or chief executives.

FOREIGN CURRENCY EXPOSURE LIMITS

PART V: EFFECTIVE DATE

1. **Effective date** - The effective date of this prudential standard shall be _____.
2. **Supersedence** - This prudential standard supersedes and replaces any previous prudential standard or guidance/explanatory note issued by the BPNG in regard to foreign exchange risk positions.

Questions relating to this prudential standard should be addressed to the Financial Systems Supervision Department.