



**Da Afghanistan Bank**

**Banking Supervision Department**

# **Open FX Regulation**

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## **Summary**

Da Afghanistan Bank (DAB) issued a regulation on open position in foreign currencies. The circulation of the regulation for comment is consistent with article 3 of banking law. The Article 3 of the Decree Law of Banking in Afghanistan (Banking Law), which requires that a regulation be published in the manner “best calculated to bring the regulation to the attention of the domestic banking industry.” If DAB determines that the delay in issuing a regulation that would be caused by circulating the regulation for public comment would be a “serious threat to the interests of the banking system” it may forego this requirement. In the case of this regulation, DAB chooses to circulate the regulation for public comment.

## **Purpose of rule**

The purpose of the regulation is to detail exposure limits on foreign exchange exposure for banking organizations. Further, it establishes required procedures for bank management in monitoring foreign exchange risk.

The adoption and full implementation of this rule is generally in keeping with Principles 12 and 13 of the Core Principles of Effective Banking Supervision of the Basel Committee.

## **Background and summary of rule**

Foreign exchange risk is but one of the many risks that banking organizations face. A supervisor must assure that banks set appropriate limits for these various market risks. Consistent with Article 35.2 of the Banking Law, which grants DAB the authority to set restrictions or conditions on unhedged positions in foreign currencies.

This regulation requires banks to calculate their individual foreign exchange positions in individual foreign currencies as well as overall net foreign exchange positions in non- convertible and all foreign currencies. The calculation of these positions will also take into account off balance sheet accounts that impact their position.

The regulation also sets limits on permissible foreign exchange risk, which will be periodically reviewed and modified by DAB. Initially, these limits are set at 20 percent of an institution’s regulatory capital in the case of individual convertible currencies and 5 percent of the institution’s regulatory capital in the case of individual non-convertible currencies. An institution’s overall net open position in non-convertible currencies shall not exceed 10 percent of the institution’s regulatory capital and overall open position in all foreign currencies shall not exceed 40 percent of the institution’s regulatory capital.

Finally, the regulation also details procedures for the management of risk, including the role of senior management, policies and procedures on open foreign exchange position and reporting requirements.

## **Part 1: General**

### **Article 1: Authority**

This regulation on foreign exchange positions is pursuant to the authority granted to DAB by Article 35.2.5 of the Decree Law of Banking in Afghanistan (Banking Law) and by Article 72 of the Decree Law of Da Afghanistan Bank (DAB Law).

### **Article 2: Definitions**

In this subpart the following terms shall have the meanings assigned:

- (1) “convertible currencies” means currencies that are widely traded in international markets and that can be freely exchanged for other currencies or gold without special authorization from the central bank responsible for the currency.
- (2) “foreign exchange position” means for an individual foreign currency, assets denominated in that currency minus liabilities denominated in that currency. A foreign exchange position of zero is referred to as a closed foreign exchange position. A positive or negative foreign exchange position is referred to as an open foreign exchange position.
- (3) “long position” means an open foreign exchange position for an individual foreign currency where assets denominated in that currency exceed liabilities denominated in that currency, plus the impact of off-balance sheet items.
- (4) “non-convertible currencies” means currencies that are not widely traded outside the home country and thus not easily convertible in international markets.
- (5) “overall foreign exchange position” means the higher in absolute terms of either the sum of all short foreign exchange positions or the sum of all long foreign exchange positions.
- (6) “short position” means an open foreign exchange position for an individual foreign currency where liabilities denominated in that currency exceed assets denominated in that currency, plus the impact of off-balance sheet items.

### **Article 3: General goals and objectives**

This regulation aims at the following:

- (1) To set forth DAB’s oversight framework for controlling exchange risk through imposition of exposure limits on:
  1. Individual foreign exchange positions in a single foreign currency.
  2. Overall net foreign exchange positions in non-convertible currencies.
  3. Overall net foreign exchange positions in all foreign currencies.
- (2) To establish various required procedures for bank management in monitoring foreign exchange risk.

## **Part 2: Calculation and Limitations**

### **Article 4: Calculation**

- (1) For the purpose of controlling foreign exchange risk, institutions shall calculate:
  1. individual foreign exchange positions in particular foreign currencies

2. overall net foreign exchange position in non-convertible currencies
  3. overall net foreign exchange position in all foreign currencies
- (2) The foreign currency balances referred to in the present regulation shall be expressed as an Afghani equivalent, translated at the relevant exchange rate for the given day.
  - (3) Balances expressed in a composite currency or unit of settlement established under international agreement, where the exchange rate for such is determined with reference to a basket of selected currencies, shall be translated into Afghani in accordance with the procedure specified in paragraph b) above and included in foreign exchange positions after first having been broken down into their component currencies in line with the weights assigned to particular currencies within the basket.
  - (4) On receipt of a justified request from a particular institution, DAB may consent to foreign currency balances of a structural (long-term) character being exempted from the calculation of foreign exchange positions.
  - (5) With reference to off balance sheet accounts, foreign exchange positions shall encompass the following:
    1. spot transactions, taken to mean off balance sheet spot foreign exchange transactions,
    2. forward and futures transactions, taken to mean contracts to sell a specified amount of underlying instruments at a specified exchange rate, with delivery of these instruments to be performed at a future date specified in the given contract,
    3. options (options purchased or sold), taken to mean contracts selling the right to the future purchase or sale of a specified amount of underlying instruments, or the right to the future conclusion of a specified forward or futures contract, with the proviso that:
      - the amount to be included in the foreign exchange position shall be the delta equivalent of the option contract, understood as the nominal value of the underlying instrument of the contract multiplied by its delta;
      - the delta shall represent the change in value of the option contract resulting from any small change in the value of the instrument underlying the option;
      - where the delta equivalent is to be calculated for exchange-traded options, the delta used should be that established by the exchange concerned; and
      - where the delta equivalent is to be calculated for over-the-counter options, the delta used should be determined using a model approved for this purpose by appropriate notification of DAB. In such cases, institutions shall be required to hold full documentation of the calculations applied.
    4. transactions identified by breaking down structured instruments into their component parts, such instruments being taken to mean contracts that provide for the simultaneous conclusion of at least two forward/futures transactions and/or options.
  - (6) The off-balance sheet accounts included in calculations of foreign exchange positions shall comprise the following items as Afghani equivalent in regular reports:
    1. amounts receivable (denoted with a plus sign) and amounts payable (denoted with a minus sign) on spot transactions,
    2. amounts receivable (denoted with a plus sign) and amounts payable (denoted with a minus

sign) on forward/futures transactions,

3. the delta equivalent of amounts receivable (denoted with a plus sign) and amounts payable (denoted with a minus sign) on option contracts (options purchased or sold),
4. amounts receivable (denoted with a plus sign) and amounts payable (denoted with a minus sign) on transactions identified by breaking down structured instruments into their component parts.

#### **Article 5: Limitations**

- (1) Normative provisions for permissible foreign exchange risk, which will be periodically reviewed and modified by DAB, are hereby set as follows:
  1. an institution's individual open foreign exchange position in any single foreign currency shall not exceed, in absolute terms (i.e., a short position or long position):
    - in the case of convertible currencies, 20% of the institution's regulatory capital,
    - in the case of non-convertible currencies, 5% of the institution's regulatory capital,
  2. an institution's overall net open foreign exchange position in non-convertible currencies shall not exceed, in absolute terms, 10% of the institution's regulatory capital,
  3. an institution's overall open foreign exchange position in all foreign currencies shall not exceed, in absolute terms, 40% of the institution's regulatory capital.
- (2) The institution' regulatory capital shall be as defined in the DAB capital regulation.
- (3) The standard percentages for institutions are applicable to banks that are well managed and operating in a sound manner. However, DAB may require more stringent percentages than those specified in paragraph a) for banks deteriorating in financial position or displaying weaknesses in management of foreign exchange risk

### **Part 3: Management of Risk**

#### **Article 6: Role of Senior Management**

Each bank should have a management structure in place to execute and oversee foreign exchange activities. The Board of Supervisors must approve and the Management Board must implement the necessary safeguards to ensure that these transactions are effectively managed, and that appropriate policies and procedures are established to control and limit risk. These safeguards would include the following:

- (1) Details on the types of transactions that the bank will be involved in, the purposes of these transactions and the limits on each type of activity.
- (2) Development of an organizational structure whereby the responsibilities of individuals and units involved in foreign exchange transactions are well defined and duties are properly segregated.
- (3) Creation of a tracking system that registers each foreign exchange transaction, properly accounts for the position and the values of those positions on an ongoing basis, allows for scenario analysis in changing markets and reports foreign exchange performance results to senior management.

- (4) Implementation of a system of internal audit that assures that the implemented controls, procedures, laws and regulations are followed.

#### **Article 7: Policies and Procedures**

Policies and procedures, developed and updated regularly, should have the following elements:

- (1) description of the bank's current and planned foreign exchange activities, including:
  1. principles and objectives review, determining the volume of foreign exchange risk for the bank;
  2. clear, prudent and detailed limits of bank's foreign exchange risk exposure, compatible with bank's operational, financial abilities and risk levels the bank is ready to accept, related to individual over-night and term limits for each currency and total over-night and term limits for all foreign currency; and
  3. broadly defined authority levels at the bank regarding foreign exchange operations and risk.
- (2) procedures for management and control of foreign exchange activities and risk, proportionally to the size, complexity and frequency of the bank's foreign exchange activities:
  1. accounting and information systems for the Board of Supervisors and the Management Board, related to the monitoring and assessment of:
    - foreign currency positions of the bank, foreign currency risk, loss and income;
    - net over-night and time-limit position of each currency (assets/liability) the institution is dealing in;
    - total net overnight and time-limit position in all currencies that the bank is dealing in;
    - income and losses regarding foreign currency activities and foreign currency risk exposure.
  2. control of foreign currency, including, at least:
    - organizational control in order to monitor whether the proper division exists between persons deciding on foreign exchange activities (transactions) and persons responsible for its execution (contracting, executing and recording);
    - procedural control to assure that all transactions are filed on the date when they occurred and are properly placed with immediate detection of non- approved transactions;
    - monitoring in order to assure compliance with regulations and established risk restrictions.

#### **Article 8: Reporting Requirements**

Banks must calculate the minimum ratios on a monthly basis as a monthly average of daily ratios and report these monthly averages to DAB within five business days of the end of each month. Banks are in violation of this regulation if the monthly averages fall below the required percentages. Banks must maintain sufficient information to enable DAB's on-site examiners to verify the banks' calculations.

#### **Part 4: Effective date of regulation**

##### **Article 9: Publication in DAB web site.**

This regulation will become effective upon adoption by the supreme council of DAB.



**Appendix**  
**Sample Calculations/Required Reporting**

Long position = 20% of capital in US Dollar

Short Position = -10% of Capital in Pak Rupees

Overall FX Position in all currencies= 20% of

Bank Name

**Open Foreign Exchange**

**Open Foreign Exchange Positions**

I. Monetary Assets	A	B	C	D	E	F	G	Line code
	Total FX Denom	U.S Dollar	Euro	British Pound	Iranian Rial	Pakistani Rupee	All other	
1. Cash in vault and Current account with DAB	50000	30000				20000		(1)
2. Claims on Financial Institutions	60000	40000				20000		(2)
3. Claims under Securities Repurchase Agreements								(3)
4. Trading Account (Except derivatives)								(4)
5. Held to maturity investments								(5)
6. Available for Sale investments								(6)
7. Loans to NFIs and Other Clients	90000	90000						(7)
8. Accrued interest Receivable and other monetary assets( except derivatives)								(8)
9. Total Monetary Assets	200,000	160,000	-	-	-	40,000	-	(9)

**II. Monetary Liabilities**

10. Deposits of Financial Insitutions						(10)
11. Deposits of NFIs and Other Clients	170000	100000			70000	(11)
12. Borrowings under Securities Repurchase Agree						(12)
13. Short tem and Long tem Borrowings						(13)
14. Subordinated Debt and debt /equity (hybrid) ins						(14)
15. Accrued Interest payable and other monetary liabilities(excpet derivatives)						(15)
16. Total Monetary Liabilities	170000	100000			70000	(16)

**III. Derivities Affecting Open Foreing Exchange Positions**

<b>17. Derivities Giving Rise to Long Positions, Tota:</b>						(17)
a Gross long Forward Agreements						(17.1)
b Gross Long Futures Contracts						(17.2)
c Purchased Options to Buy Foreing Exchange						(17.3)
d Written Options to Buy foreing Exchange						(17.4)
e Other Derivities Giving Rise to Long positions						(17.5)
<b>18. Derivities Giving Rise to short positions, total:</b>						(18)
a Gross short Forward Agreements						(18.1)
b Gross short Futures Contracts						(18.2)
c Purchased Options to sell Foreing Exchange						(18.3)
d Written Options to sell foreing Exchange						(18.4)
e Other Derivities Giving Rise to short positions						(18.5)
19. Total Open Foreing Exchange Position ( 9-16+17-18)	60000	60000			-30000	(19)
20 Regulatory Capital	300000	300000			300000	
21 Open Foreign Exchange Positions as % of Reg. C	20%	20%			-10%	

the Bank CEO \_\_\_\_\_

Date \_\_\_\_\_

Responsible Person Name (name and phone) \_\_\_\_\_

Signature \_\_\_\_\_