



RESERVE BANK OF MALAWI

DIRECTIVE

NO. DO1-97/FX

FOREIGN CURRENCY EXPOSURE LIMITS

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DIRECTIVE NO. DO1-97/FX

FOREIGN CURRENCY EXPOSURE LIMITS

PART I: PRELIMINARY

Sec. 1: Short Title - Foreign Currency Exposure Limits.

Sec. 2: Authorization - Specific authority is granted by Section 28(b) of the Banking Act of 1989, and general authority is provided under Sections 15, 27, 28, and 38 of the Banking Act of 1989.

Sec. 3: Application - All banks licensed by the Reserve Bank of Malawi to deal in foreign exchange activities.

Sec. 4: Definitions - The following terms shall be defined as specified below unless the context in which such term appears requires otherwise:

- 1) "capital base" - a bank's qualifying capital base for purposes of calculating foreign exchange risk exposure shall be its core (Tier I) capital, namely:
 - a) Share capital, paid-up;
 - b) Share premium;
 - c) Retained profits (prior years);
 - d) 60% of after tax profit (current year-to-date);
 - e) Less: Investment in unconsolidated companies.
- 2) "foreign currency deposit" - any deposit of a customer where such deposit is held in an account which is denominated in a currency other than the Malawi Kwacha.
- 3) "foreign currency exposure" - the domestic currency equivalent sum, currency by currency, of all foreign currency denominated assets and liabilities. No foreign currency denominated assets or liabilities may be omitted unless explicitly agreed to by the Reserve Bank of Malawi; both on-book and off-book.
- 4) "overall foreign exchange risk exposure" - the sum of the potential gains and losses (i.e. net short and long positions in foreign currencies), expressed as a domestic currency equivalent amount at the spot buying exchange rates, that a bank may incur as a result of variations in the exchange rates of the underlying foreign currencies.
- 5) "intraday foreign exchange risk exposure" - the foreign exchange risk exposure, as a sum of all currencies, which a bank incurs between the opening of business on one day and the opening of business the following day.

- 6) "liabilities to the public" - all claims against a bank or financial institution which are payable on demand or at a specified future date.
- 7) "required reserves" - funds to be placed on account at the Reserve Bank of Malawi by a depository institution for the purpose of satisfying the liquidity reserve requirement stipulated by the Reserve Bank of Malawi.
- 8) "spot buying rate" - the rate, expressed in domestic currency equivalent, at which a foreign currency may be purchased for settlement within 2 days.

PART II: STATEMENT OF POLICY

Sec. 1: **Objectives** - The purpose for this directive is to establish prudential limits within which foreign exchange positions may be held. In so doing, this directive seeks:

- 1) to maximize a financial institution's ability to conduct business in a sound and viable manner and for the convenience of its customers;
- 2) to minimize the potential for risk of loss to an institution's capital base and;
- 3) to promote favourable competition in the access to and availability of foreign exchange.

PART III: IMPLEMENTATION AND SPECIFIC REQUIREMENTS

Sec. 1: **Limit on overall foreign exchange risk exposure** - The aggregate of a foreign exchange risk exposure (short and long currency positions) both on-book and off-balance sheet, as measured using spot buying rates, shall not exceed 35% of the bank's capital base at any time.

Sec.2: **Limit on intraday foreign exchange risk exposures** - Intraday foreign exchange risk exposures, both in single currencies and overall, shall be maintained within prudential limits as established by the board of directors of each bank.

Sec. 3: **Global limits** - The aggregate foreign exchange risk exposure limits imposed by Section 1 above shall apply to each bank on a "global" basis, that is, an institution may have different internal limits for its various branches; however, compliance with the limit will be measured on a global basis by considering the entire financial

institution as a single consolidated entity.

Sec. 4: **Computation of foreign exchange risk exposures** - Each bank shall calculate its individual currency and overall foreign exchange risk exposures daily using Forms, A,B,C and D provided herewith.

Sec. 5: **Correction of excess foreign exchange risk exposures** - Each bank shall immediately, but not later than close of business the following day, correct the foreign exchange risk exposure which shall exceed the limit specified above. Failure to do so may result in administrative sanctions as set forth below.

Sec. 6: **Maintenance of supporting documentation** - Each bank shall maintain records which make available to the bank's treasury management functions at all times, the amounts of individual currency and overall foreign exchange risk exposures. Each bank shall also prepare and maintain a daily record showing the end-of-day foreign exchange risk exposures and also showing a reconciliation of the opening to closing positions. Sample forms (Form B and C) for such reports are provided herewith.

Sec. 7: **Submission of weekly reports to Reserve Bank** - Each bank shall submit to the Reserve Bank of Malawi Forms B and C showing the amounts of foreign exchange risk exposures for each day of the preceding week. Such reports shall be submitted by close of business on the first business day of each week.

PART IV: REMEDIAL MEASURES AND ADMINISTRATIVE SANCTIONS

Sec. 1: **Remedial measures** - If the Reserve Bank of Malawi determines that a bank is not in compliance with this directive, then:

- 1) remedial measures may be imposed in accordance with Section 31 and Section 39 of the Banking Act of 1989.
- 2) if such noncompliance has resulted or threatens to result in an unsafe or unsound operating condition, the remedial measures as provided under Section 32 of the Banking Act of 1989 may also be applied.

Sec. 2: **Administrative sanctions** - In addition to the remedial measures available for use as provided in Sec. 1 above, the Reserve Bank may impose any or all of the following administrative sanctions upon an institution or its board of directors or managing officers for noncompliance with this directive:

- 1) Prohibition from dealing in further foreign exchange activities of any kind;
- 2) Prohibition from declaring and/or paying dividends;
- 3) Prohibition from establishing new branches or facilities;
- 4) Prohibition from engaging in new services or activities or from expanding existing services or activities;
- 5) Suspension of access to Reserve Bank credit facilities;
- 6) Suspension of lending, investment, and credit extension operations;
- 7) Prohibition from acquiring of additional fixed assets;
- 8) Prohibition from accepting further deposit liabilities;
- 9) Prohibition from declaring and/or paying bonuses, salary incentives, severance packages, management fees, or other discretionary compensation schemes to directors or managing officers.

PART V: EFFECTIVE DATE AND SUPERSEDEANCE

Sec. 1: **Effective date** - The effective date of this directive shall be -----
-----.

Sec. 2: **Supersedeance** - This directive shall supersede and replace Directive No. DO2-94a/FX issued with effect from 1st August, 1995.

Questions relating to this Directive should be addressed to the Director of the Bank Supervision Department of the Reserve Bank of Malawi.

Victor Mbewe
GOVERNOR

APPENDIX I

SAMPLE COMPUTATION OF FOREIGN RISK EXPOSURE

The following example illustrates the calculations necessary to determine the foreign exchange risk exposures in a single currency and overall for all currencies in which the bank has a position.

A. Qualifying capital base:

Share capital, paid-up	20,000
Share premium	6,000
Retained profits (prior years)	2,500
60% after tax profits (current YTD)	<u>1,500</u>
Total capital base	30,000

B. Positions in foreign currencies (a minus sign indicates a short position):

Foreign Currency Positions

<u>Currency</u>	<u>Balance Sheet</u>	<u>Forward</u>	<u>Total</u>
USD	500	-800	-300
UK	500	-200	300
FRF	-1,000	1,600	600
NLG	200		200
BEF	3,000	-800	2,200
ATS	-1,900	300	-1,600
JPY	200	700	900

To calculate the risk exposures in relation to the limits:

1. Identify the prevailing spot buying rates for each currency in which a position exists, i.e.;

USD	7.486
UK	4.464
FRF	1.309
NLG	3.959
BEF	0.216
ATS	0.634
JPY	0.056

2. Compute the local currency equivalent of the spot and forward positions in each foreign currency:

Net domestic currency equivalent positions by currency:

	<u>Balance Sheet</u>		<u>Forward</u>		<u>Overall</u>	
	<u>Long</u>	<u>Short</u>	<u>Long</u>	<u>Short</u>	<u>Long</u>	<u>Short</u>
USD	3,743			-5,989		-2,246
UK	2,223			-893	1,339	
FRF		-1,310	2,095		785	
NLG	792				792	
BEF	650			-173	477	
ATS		-1,205	190			-1,015
JPY	11		40		51	
	<u>7,428</u>	<u>2,515</u>	<u>2,325</u>	<u>-7,055</u>	<u>3,444</u>	<u>-3,261</u>
Net	4,913			-4,730		-183
Total long/ short positions					<u>3,444</u>	<u>-3,444</u>
Overall position against domestic currency						183

3. Add up the local currency equivalent of all long and short foreign currency positions. The sum of all long or (short) positions is 3,444 or (-3,444), while the overall foreign currency position is 183, i.e., a long position.

$$\text{Ratio} = \frac{3,444}{30,000} = 11.5\%$$

Compare this ratio with the 35% maximum risk limit. Since it is lower than 35%, the overall net foreign risk exposure is within the acceptable limit.

- C. Foreign currency risk exposures on both an individual currency basis and overall must be available to the treasury management function of a commercial bank at all times. On a weekly basis, banks must report summary statistics on their transactions in the foreign exchange market between foreign currencies and the domestic currency, by counterparty. The amounts which must be reported are the domestic currency equivalents of the transactions. The transactions are for the spot date, not the value date. The

reports should have the format and content as illustrated in Appendix II, Exhibit 2.