Jersey Financial Services Commission

Guidance Note

Prudential reporting of market risk under the standardised approach to market risk

Issued December 2018

Glossary

The following abbreviations are used within the document:

DvP	Delivery versus Payment
SAM	Standardised Approach to Market risk
CD	Certificate of Deposit
FRN	Floating Rate Note
JIB	Jersey incorporated registered deposit takers

Contents

1 Overview

Introduction

1.1 Market risk is defined as the risk of losses in on- and off-balance sheet positions arising from movements in market prices. This guide addresses the JFSC's requirements of Jersey incorporated registered deposit takers, who are referred to herein as **JIBs**. JIBs with a trading book should complete the relevant reports for the trading book and report only banking book positions within the Prudential Return. All other JIBs should report all relevant risks using the relevant data entry sheets in the Prudential Return.

1.2 The market risks that generate a capital requirement in Jersey for all JIBs are:

1.2.1 Foreign exchange risk; and

1.2.2 Commodities risk.

1.3 The Prudential Return and guidance also cover settlement risk, the risks that arise through failed delivery versus payment ("**DvP**") transactions and free delivery transactions. This treatment is the same for banking book and trading book transactions.

1.4 The rules set out here relate to the completion of four data entry sheets in the Prudential Return. These are:

1.4.1 5.1 FX & Gold

1.4.2 5.2 Commodities

1.4.3 5.3 Settlement Risk - Credit Risk

1.4.4 5.4 Settlement Risk - Capital

1.5 JIBs are reminded of the requirement to ensure that they adhere to their minimum risk asset ratio requirement at all times. Where material positions are permitted by the JIB's risk limit structure, related capital requirements must be calculated daily. Settlement risk must be calculated daily for all JIBs that may have failed trades.

2 Sheet '5.1 FX and Gold'

Introduction

2.1 The risks arising from foreign currency and gold exposures is similar and hence the form addresses both. In both cases, the bank is allowed to offset current and future exposures to arrive at a net figure.

Foreign Exchange Positions

2.2 Do not report any position for the reporting currency of your bank; the return calculates a balancing item corresponding to the effective position in this currency. For most JIBs, this means that row A.1 (pounds sterling) should be blank.

2.3 The major currencies should be reported separately, namely Pounds Sterling (**GBP**), US Dollars (**USD**), Euros (**EUR**), Swiss Francs (**CHF**), Canadian Dollars (**CAD**), Japanese Yen (**JPY**) and Australian Dollars (**AUD**). Other currencies should be split into two groups according to whether the bank is long or short, as follows:

2.3.1 **Other – Long Currencies**: group together currencies where the net overall position in each individual currency is positive;

2.3.2 **Other – Short Currencies**: group together currencies where the net overall position in each individual currency is negative.

2.4 Note that the "net overall position" is the sum of all balance sheet assets less balance sheet liabilities plus/minus net forward purchases/sales.

2.5 All input figures should correspond to the gross amount.

A: Foreign Currency Positions

Item	Completion Notes
A.1 to A.9	**Balance Sheet Assets.** Total balance sheet assets denominated in the foreign currency or group of currencies.
	Balance Sheet Liabilities. Total balance sheet liabilities denominated in the foreign currency or group of currencies.
	Spot - Net. A calculated field, being equal to "Balance sheet assets" less "Balance sheet liabilities" and representing the net spot position.
	Forward Gross Purchases. All forward purchases of the foreign currency or group of currencies.
	Forward Gross Sales. All forward sales of the foreign currency or group of currencies.
	Forward - Net. A calculated field, being equal to "Forward Gross Purchases" less "Forward Gross Sales" and representing the net forward position.
	Total. A calculated field, being the sum of the net spot position and the net forward position. NB a negative value here indicates a short position; a positive value indicates a long position.

A.10	**Balancing item.** A calculated field, being the position required to make the overall total of net long and short positions, in all currencies taken together equal to zero.
A	**Aggregate net long open positions.** A calculated field being the sum of all long positions including the entry for the “sterling balancing item” if it is positive. This aggregate of net long open positions, which will be positive or zero, is included in the risk asset ratio calculation.

B.0: Gold

2.6 Report any position for gold. Note that the net overall position in gold is the sum of all balance sheet gold assets less balance sheet gold liabilities plus/minus net forward purchases/sales of gold.

2.7 All input figures should correspond to the gross amount.

Item	Completion Notes
B.0	**Balance Sheet Assets.** Total balance sheet gold assets
	Balance Sheet Liabilities. Total balance sheet gold liabilities.
	Spot - Net. A calculated field, being equal to “Balance sheet assets” less “Balance sheet liabilities” and representing the net spot position.
	Forward Gross Purchases. All forward purchases of gold.
	Forward Gross Sales. All forward sales of gold.
	Forward - Net. A calculated field, being equal to “Gross purchases” less “Gross sales” and representing the net forward position.
	Total. A calculated field, being the sum of the net spot position and the net forward position. NB a negative value here indicates a short position; a positive value indicates a long position.

D: Risk Weighted Assets

Item	Completion Notes
D.0	**Risk Weighted Asset Equivalent.** The equivalent Risk Weighted Asset figure is calculated, being the sum of A.0 - Aggregate net long Open positions plus the absolute value of the Total for B.0 – Gold.

3 Sheet '5.2 Commodities'

Introduction

3.1 All commodity positions should be reported using this part of the form except gold, which is treated as a currency and reported within sheet 5.1 FX & Gold – see Section 2. The JIB is required to offset current and future exposures to arrive at a net position, and the capital charge (Simplified Approach) is made up of elements for the net and gross positions.

Reporting and calculation of capital charge

3.2 The groupings are:

- A.1: Precious metals (excluding gold)
- A.2: Base metals
- A.3: Energy contracts
- A.4: Other Contracts

3.3 All input figures should correspond to the gross amount.

A: Commodity Positions

Item	Completion Notes
A.1 to A.4	**Gross Long** All long positions of each commodity group.
	Gross Short All short positions of each commodity group.
	Net Position A calculated field, being equal to Gross Long less Gross Short.
	Simplified Approach A calculated field, being equal to 15% of the absolute value of the Net Position plus 3% of the sum of Gross Long plus Gross Short.
A.0	**Gross Long** A calculated field, being the sum of the Gross Long positions entered for all commodity groups (A.1 to A.4).
	Gross Short A calculated field, being the sum of the Gross Short positions entered for all commodity groups (A.1 to A.4).
	Net Position A calculated field, being the sum of the Net Positions derived for all commodity groups (A.1 to A.4).
	Simplified Approach A calculated field, being the sum of the Simplified Approaches derived for all commodity groups (A.1 to A.4).

B: Risk Weighted Asset Equivalent

Item	Completion Notes
B.0	**Risk Weighted Asset Equivalent.** The equivalent Risk Weighted Asset figure is calculated, being 12.5 times the Simplified Approach for A.0.

C: Top Five Commodities

3.4 C.1 to C.5 are completed in the same manner as A.1 to A.4, except that:

3.4.1 instead of reporting all positions, split by group, the JIB need only report the five commodities that produce the largest Simplified Approach charge.

3.4.2 The name of the relevant commodity must be provided in the column headed "Commodity" (no more than 50 characters).

3.5 No breakdown is required where the charge is less than 1% of capital.

4 Settlement Risk

Introduction

4.1 Settlement risk arises through non-DvP trades (free deliveries) and failed DvP trades.

Sheet '5.3 Settlement Risk - Credit Risk: Free Deliveries'

4.2 A free delivery occurs when a JIB has paid away (or received) its side of a transaction and has yet to receive (or pay away) the securities/cash concerned. For free deliveries, an immediate exposure arises where a JIB has settled its side of the transaction but has yet to receive the countervalue. The JIB will be deemed to have a claim on the other party for the amount of the cash or equivalent to the current market value of the securities, whichever is still outstanding.

4.3 For example, if Bank A sells shares in Company C to Bank B and if Bank B pays for the shares immediately and Bank A is to deliver at some future date, Bank B should hold capital for counterparty risk on Bank A in addition to capital for the risk relating to holding Company C shares. This is because Bank B is exposed for the whole amount of the value of the shares to Bank A until delivery takes place.

4.4 The requirement for free deliveries should be calculated as:

4.4.1 Four working days or less past settlement date: The risk weighted assets (**RWA**) should be the counterparty claim multiplied by the counterparty risk weight;

4.4.2 More than four working days past settlement date: The counterparty claim must be provided a capital treatment – see Sheet 5.4 Settlement Risk - Capital

4.5 For clarity, this treatment should also be applied to exchange traded contracts involving physical delivery. No requirements arise in respect of delivery risk on spot and forward foreign exchange transactions are considered necessary.

4.6 Where the transaction is effected across a national border, the JFSC considers that there is a window of one working day before the exposure should be included in the return.

C: Free delivery transactions, 4 days or less since delivery

Item	Completion Notes
C.1.1 to C.1.5	**Risk Weight** Transactions should be recorded in accordance with the credit risk weight for the counterparty under the Standardised Approach.
	Number of Trades. Number of trades four days or less past settlement, by the risk weight.
	Mark-to-Market Receivable. Receivable mark-to-market amounts, by counterparty RW.
	RWAs. A calculated field, being equal to the "mark-to-market receivable" multiplied by the risk weight.
C.1 Total	**Number of Trades.** The sum of the Totals for C.1.1 to C.1.5.
	Mark-to-Market Receivable. The sum of the Mark-to-Market Receivable for C.1.1 to C.1.5.
	Risk Weighted Assets The sum of the RWAs for C.1.1 to C.1.5.

Sheet '5.4 Settlement Risk-Capital': Failed DvP trades and non-DvP trades that are more than 4 days past settlement date.

4.7 Whether or not a transaction involving the delivery of an instrument against the receipt of cash attracts a counterparty risk charge during its life, a capital charge should apply in cases of unsettled transactions as defined below.

4.7.1 An unsettled transaction is one where delivery of the instrument is due to take place against the receipt of cash, but which remains unsettled more than 4 business days after the due settlement date.

4.7.2 As an example of where this is applicable, if Bank A sells shares in Company C to Bank B and Bank A fails to deliver on time, Bank B should hold capital for counterparty risk on Bank A in addition to capital for specific risk on Company C. This is because if the price moves in Bank B's favour, then the risk is that Bank A will not deliver and Bank B will have to pay a higher price to replace the purchase.

4.8 In principle, JIBs' systems should be set up in such a manner that, where a deal attracts a counterparty risk charge, this charge continues to apply when settlement is due but has not been completed. JIBs are expected to adopt this for all such transactions.

4.9 No capital charges in respect of settlement risk on spot and forward foreign exchange transactions of any type are considered necessary.

4.10 For the avoidance of doubt, this sheet should be used to report non-DVP trades that attract a capital treatment (see paragraph 4.4.2)

4.11 Unsettled transactions should attract a capital cost based upon the difference between the amount due and the current market value of the instrument, if this has a potential loss. The capital requirement should be this potential loss multiplied by the factor in the table below.

4.12 This applies only to trades where a loss may arise for the JIB if the trade fails to settle. Failed trades must be reported once the date is more than four days after the agreed settlement date.

4.13 Note that the capital requirement for such transactions is not multiplied by the counterparty risk weight.

A: Factors for failed DvP transactions

Number of working days after due settlement date.	Item	Factor
5 – 15	A.1	8%
16 – 30	A.2	50%
31 – 45	A.3	75%
46 or more	A.4	100%

4.14 For failed non-DVP trades that are more than 4 days past settlement date, the Factor is 100%.

4.15 The figures that must be reported are:

Item	Completion Notes
A.1 to A.4 C.2	**Number of Trades.** Report number of failed trades, by date.
	At risk amount: Loss if trade fails/Mark-to-Market Receivable. For failed DvP trades, enter the mark to market loss of each trade and report the sum of these, ignoring gains. For non-DvP trades, enter the Mark-to-Market Receivable.
	Capital Risk. The capital charge is calculated by the sheet, being the relevant factor multiplied by the Loss if trade fail/Mark-to-Market Receivable.

D: Total

Item	Completion Notes
D.0	**Number of Trades.** Calculated as the total Number of Trades for A.1 to A.4 plus C.2.
	Loss if trade fails/Mark-to-Market Receivable. Calculated as the total Loss if trade fails/Mark-to-Market Receivable for A.1 to A.4 plus C.2.
	Capital Risk. Calculated as the total Capital Risk for A.1 to A.4 plus C.2.