



MODULE 4

Guidance to completing the Market Risk module of BSL/2

Market Risk

Introduction

This guidance outlines the Commission's reporting requirements for calculating how much capital should be held by banks against potential losses arising out of market risk.

Market risk is defined as the risk of losses in on and off balance sheet positions arising from movements in market prices. The risks subject to this requirement are:

- The risks pertaining to interest rate related instruments and equities in the trading book; and
- Foreign exchange, gold and commodities risks throughout the bank.

Trading book risks

The Commission has determined through its annual Trading Book Survey¹ that Guernsey banks do not run material trading books. Should a Guernsey bank inform the Commission that it has developed a material trading book then any capital charge determined to address risks arising from that trading book will be decided upon in the Supervisory Review and Evaluation Process of Pillar 2.

Foreign exchange and gold risk

The forms and guidance set out a minimum capital standard to cover the risk of holding or taking positions in foreign currencies, including gold. The Commission is adopting the "shorthand" method of calculating this risk as described by the Basel Committee on Banking Supervision in Basel II document. This follows closely the methodology previously used to report this risk to the Commission in form BSL/1. The overall net open position is measured by aggregating the sum of net short positions (converting foreign currency positions at spot rates into the reporting currency) along with the net position (long or short) in gold, regardless of the sign. The capital charge will be 8% of the overall net open position.

Commodities Risk

The forms and guidance set out a minimum capital standard to cover the risk of holding or taking positions in commodities. The capital charge is calculated using the Simplified Approach as described in the Basel II document. The capital charge is 15% of the net position, long or short, in each commodity plus 3% of the bank's gross positions, long plus short, in that particular commodity. In valuing the gross positions in commodity derivatives for this purpose, banks should use the current spot price.

¹ Along with the undertaking, signed by bank management when completing the survey, that the bank will advise the Commission in the event that it begins to operate a trading book or ceases to operate a trading book

Market Risk reporting forms

MODULE 4				
STANDARDISED APPROACH TO MARKET RISK - FX & Gold				
A	Currency/Gold	Net spot claims (liabilities)	Net forward purchases (sales)	Net overall long/short position
A.1	GBP			0
A.2	USD			0
A.3	EUR			0
A.4	CHF			0
A.5	CAD			0
A.6	JPY			0
A.7	AUD			0
A.8	All other - Long			0
A.9	All other - Short			0
A.10	Balancing Item			0
A.11 Aggregate Net Long Open position				0
B	Gold			0
C	Capital Requirement			0
D	Risk Weighted Asset Equivalent			0

MODULE 4					
STANDARDISED APPROACH TO MARKET RISK - Commodities					
A	Commodity Types	Positions			Capital Charges
		Gross Long	Gross Short	Net Open Position	Simplified Approach
A.1	Precious metals (excluding gold)			0	0
A.2	Base metals			0	0
A.3	Energy contracts			0	0
A.4	Other Contracts			0	0
A.5	Total	0	0	0	0
B	Risk Weighted Asset Equivalent				0

Guidance on completion of the Market Risk reporting forms**SECTION 1 OVERVIEW**

1.1 This guidance relates to the completion of the following reporting forms:

- Foreign exchange & gold risk;
- Commodities risk;

1.2 Market risk is defined as the risk of losses in on and off-balance sheet positions arising from movements in market prices. Subsidiaries with a **material trading book** contact the Commission to discuss how risks arising

from the trading book should be addressed by the bank under its ICAAP drawn up in accordance with Pillar 2. All Subsidiaries should report all other relevant market risks using this form. The risks subject to a capital requirement in Guernsey for all banks are:

- Foreign exchange & gold risk; and
- Commodities risk.

1.3 Subsidiaries are reminded of the requirement that they adhere to the 8% minimum risk asset ratio and minimum capital requirements at all times. Where material positions are permitted, these capital requirements must be calculated daily.

1.4 The risks arising from foreign currency and gold exposures are similar which is why they are included in the same form. In both cases the bank is allowed to offset current and future exposures to arrive at a net position.

SECTION 2 FOREIGN EXCHANGE AND GOLD POSITIONS

2.1 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 Guernsey incorporated deposit takers line A.1 will be blank.

2.2 The major currencies should be reported separately, namely pounds sterling ("GBP") (subject to 2.1 above), 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.

2.3 All Other – Long. Group together other, smaller currency positions where the net overall position in that individual currency is positive.

All Other – Short. Group together other, smaller currency positions where the net overall position in that 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 Table A: Foreign Currency Positions

LINE	Description	COMPLETION NOTES
A.1 to A.9	Net spot claims (liabilities)	Gross assets less gross liabilities.
	Net forward purchases (sales)	Gross forward purchases less gross forward sales
	Net overall long/short position	This line is system generated and is the sum of net spot positions and the net forward purchases. A negative value here indicates a short position; a positive value indicates a long position.

A.10	Balancing item	This line is system generated, being the position required to make the overall total of net long and short positions, in all currencies taken together equal to zero.
A.11	Aggregate net long open position	This line is system generated and is 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.

Gold

2.6 Report any positions in 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 Table B: Gold:

LINE	Description	COMPLETION NOTES
B	Net spot claims (liabilities)	Gross spot gold assets less gross spot gold liabilities.
	Net forward purchases (sales)	Gross forward purchases of gold less gross forward sales of gold.
	Net overall long/short position	This line is system generated and is the sum of the net spot position and the net forward purchases entries.

Capital Requirement and Risk Weighted Asset Equivalent

2.8 Line C calculates the capital charge, being 8% of the sum of the “Aggregate net long open position” from Line A and 8% of the absolute value for the net open position in gold from Line B.

2.9 Line D calculates the equivalent Risk Weighted Asset figure, being 12.5 times the figure computed in Line C.

SECTION 3 COMMODITY RISK

Introduction

3.1 All commodity positions should be reported using this part of the form except gold, which is treated as a currency and is reported within “Foreign exchange & gold” – see Section 2. The bank is allowed to offset current and future exposures to arrive at a net position, and the capital charge is made up of elements for the net and gross positions.

Reporting and calculation of capital charge

3.2 Table A: Commodity Positions

Line	Description	COMPLETION NOTES
A.1 to A.4	Gross Long	Report all long positions for each class of commodity.
	Gross Short	Report all short positions for each class of commodity.
	Net Open Position	This line is system generated and is equal to Gross Long less Gross Short.
	Simplified Approach	This line is system generated and is equal to 15% of the Net Open Position plus 3% of the Gross Long position plus 3% of Gross Short position.
A (Total)	Gross Long	This line is system generated and is the sum of A.1 to A.4.
	Gross Short	This line is system generated and is the sum of A.1 to A.4.
	Net Open Position	This line is system generated and is the sum of the absolute values of A.1 to A.4.
	Simplified Approach	This line is system generated and is the sum of A.1 to A.4.

Risk Weighted Asset Equivalent

- 3.3 Line B calculates the total capital charge from Line A and the equivalent Risk Weighted Asset figure, being 12.5 times this charge.