RULES
on Foreign Exchange Balance

Article 1
Scope

These Rules, which are set on the basis of Article 13 of the Act on the Central Bank of Iceland, no. 36/2001, apply to consolidated financial undertakings and parent companies that have been granted an operating licence pursuant to Article 4, Paragraph 1, Items 1-4 of the Act on Financial Undertakings, no. 161/2002, with subsequent amendments, as is further specified in these Rules.

Article 2
Definitions

Party unprotected against exchange rate risk: For the purposes of these Rules, a party unprotected (unhedged) against exchange rate risk is either a party that does not have sufficient income in currencies other than the Icelandic króna to service a loan when it is issued or one that is not fully hedged against movements in the exchange rate of the Icelandic króna via derivatives contracts concluded with a financial undertaking.

Derivatives contract for hedging purposes: For the purposes of these Rules, a derivatives contract for hedging purposes is one that satisfies all of the following conditions: the contract pertains to a transaction in Icelandic krónur versus a foreign currency; the purpose of the contract is to correct a foreign exchange imbalance; and the scope and duration of the proposed hedging instrument does not exceed that required by the foreign exchange imbalance. Examples of derivatives contracts for hedging purposes are: economic hedging for domestic non-holding companies' debt in order to protect specified payment dates and interest payment dates of obligations in the future, so that the currency composition better reflects the balance sheet and revenues of the company concerned; currency hedging in order to protect expected payment flows relating to direct investment; and operational hedging for non-holding companies.

Common equity Tier 1 capital: Equity items that satisfy the requirements specified in Article 84(a) of the Act on Financial Undertakings, no. 161/2002.

Subsidiary: An undertaking falling under the definition of a subsidiary according to Article 1(a), Item 10 of the Act on Financial Undertakings, no. 161/2002.

Capital base: Capital according to Article 84, Paragraph 1 of the Act on Financial Undertakings, no. 161/2002.

Assets and liabilities in foreign currency: Assets, liabilities, and off-balance sheet items in foreign currency, as well as domestic-currency items that are based on foreign currency exchange rates.

Forward position: All transactions in foreign currency that are settled three business days or more after the trade date, including currency swaps and other swaps.

Total foreign exchange balance: The sum of a financial undertaking's positive open foreign exchange positions (net long position) less the sum of its negative open foreign exchange positions (net short position).

Systemically important supervised entity: An entity that the Financial Stability Council has classified as systemically important; cf the Act on a Financial Stability Council, no. 66/2014.

Credit undertaking: A financial undertaking that has been granted an operating licence in accordance with Article 4, Paragraph 1, Items 1-4 of the Act on Financial Undertakings, no 161/2002, with subsequent amendments; cf. Article 4, Paragraph 2 of the same Act.

Parent company: For the purposes of these Rules, a parent company as defined in the Act on Financial Undertakings, no. 161/2002, provided that it is a credit undertaking.

Counterparty: A counterparty is forward contracts that is either a financial or non-financial counterparty as defined in Article 2, Items 8 and 9 of Regulation (EU) no. 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories, published in the EEA Supplement to the Official Journal of the European Union, no. 17 of 16 March 2017, pp. 412-470; but with the adaptations that follow from Decision no. 206/2016 of the EEA Joint Committee of 30 September 2016, published in the EEA Supplement to the Official Journal of the European Union, no. 13 of 23 February 2017, pp 63-71; cf also Article 2 of the Act on Derivatives, Central Counterparties, and Trade Repositories, no. 15/2018; or a counterparty other than a financial or non-financial counterparty according to the above.

Current position in a foreign currency: Assets and liabilities in a single currency, including spot transactions.

Spot transaction: A transaction that is settled no later than two working days after the trade date.

Open foreign exchange position: All assets and liabilities, as well as off-balance sheet items, for which a credit undertaking itself bears exchange rate risk. The definition of risk shall be based on the Act on Financial Undertakings, no 161/2002, as appropriate.

Consolidated credit undertaking: For the purposes of these Rules, a consolidation of parent company and subsidiary(-ies) as defined in the Act on Financial Undertakings, no. 161/2002, provided that the parent company is a credit undertaking.

Article 3
Itemisation of assets and liabilities in foreign currency

Credit undertakings are required to itemise their current assets in the following manner in a monthly report to the Central Bank:

1. Deposits with the Central Bank of Iceland
2. Term deposits with the Central Bank of Iceland
3. Nostro accounts
4. Other deposits and interest-bearing agreements
5. Listed bonds and bills issued by a state, central bank, international institution, or international development bank, or securities bearing a guarantee from these entities; cf. Articles 18 and 21 of the Financial Supervisory Authority’s Rules on Prudential Requirements for Financial Undertakings, no. 233/2017.
6. Other listed bonds and bills
7. Listed equities
8. Unlisted equities
9. Unit shares, mutual funds, investment funds, and institutional investment funds
10. Short-term loans; i.e., loans granted for periods shorter than one year

10.a Loans granted to parties unprotected against exchange rate risk

11. Long-term loans; i.e., loans granted for periods of one year or longer

11.a Loans granted to parties unprotected against exchange rate risk

12. Claims due to spot transactions
13. Assets other than those specified above

Credit undertakings are required to itemise their current liabilities in the following manner in a monthly report to the Central Bank:

1. Transactions with the Central Bank of Iceland according to the Bank’s current Rules on Central Bank Facilities for Financial Undertakings, excluding forward transactions
2. Liabilities towards Central Bank of Iceland other than those specified in Item 1
3. Collateralised loans and with parties other than the Central Bank of Iceland
4. Issued bills

5. Issued bonds with an original maturity of less than one year
6. Issued bonds with an original maturity of one year or longer
7. Covered bonds issued in accordance with the Act on Covered Bonds, no. 11/2008, and other contractual covered bonds
8. Syndicated loans
9. Bilateral loan agreements with financial undertakings
10. Interest-bearing agreements and deposits from financial undertakings
11. Interest-bearing agreements and deposits from pension funds, mutual funds, and investment funds
12. General deposits
13. Obligations due to spot transactions
14. Liabilities other than those specified above

Credit undertakings are required to itemise their forward assets in the following manner in a monthly report to the Central Bank:

1. Forward foreign currency agreements (FX forwards)
2. Forward foreign currency swap agreements (FX swaps)
3. Cross-currency interest rate swaps
4. Options
5. Other assets creating a forward position

Financial undertakings are required to itemise their forward liabilities in the following manner in a monthly report to the Central Bank:

1. Forward foreign currency agreements (FX forwards)
2. Forward foreign currency swap agreements (FX swaps)
3. Cross-currency interest rate swaps
4. Options
5. Other liabilities creating a forward position

Forward asset and liability positions shall also be itemised by domestic and foreign counterparty in the following manner in a monthly report to the Central Bank:

1. Financial counterparties:
   a. Credit undertakings
   b. Investment companies
   c. Pension funds
   d. Insurance and reinsurance companies
   e. Mutual funds, investment funds, institutional investment funds, collective investment undertakings (CIU), and their management companies
   f. Other financial entities
2. Non-financial counterparties:
   a. Fishing and fish processing
   b. Industry
   c. Utilities, etc.
   d. Construction
   e. Wholesale and retail sale
   f. Transport, etc.
   g. Finance- and insurance-related activities
   h. Services, other
   i. Individuals
   j. Other
3. Other counterparties:

Forward assets and liabilities shall also be itemised by time range in the following manner in the monthly report:

1. Derivatives with a residual maturity of up to one month
2. Derivatives with a residual maturity from one month to three months
3. Derivatives with a residual maturity from three months to six months
4. Derivatives with a residual maturity from six months to one year
5. Derivatives with a residual maturity from one year to three years
6. Derivatives with a residual maturity from three years to five years
7. Derivatives with a residual maturity of five years or more

Derivatives entered into for the purpose of hedging by the counterparty shall be specified separately in reports.

Article 4

Calculation of open foreign exchange position

The calculation of the open foreign exchange position shall include the following items:

1. All assets in foreign currency less liabilities in foreign currency, but including accrued interest not yet due and payable (net current position)
2. The position of forward contracts, futures, and currency swaps, insofar as these agreements are not included in the net current position (net forward position). Currency swap agreements and forward contracts shall be treated as an asset in one currency and as a liability in the other
3. Irrevocable guarantees in foreign currency and similar instruments that are certain to be called and unlikely to be reclaimable
4. Total net delta value of currency options. Credit undertakings that trade in options shall calculate delta values in accordance with the Financial Supervisory Authority Regulation on Prudential Requirements for Credit Institutions, no. 233/2017
5. The market value of derivatives contracts in foreign currency other than those specified in Items 2 and 4 above

In calculating the open foreign exchange position, all asset and liability items shall carry a weight of 100%.

In calculating the open foreign exchange position in individual currencies, it is necessary to itemise multi-currency financial instruments according to the weight of each currency in the currency concerned.

In calculating the open foreign exchange position, amounts shall be converted using the central exchange rate (mid-rate) of the Icelandic króna as it is published on the Central Bank of Iceland website. Market makers in the foreign exchange market are permitted, however, to use the end-of-day exchange rate.

In calculating the open foreign exchange position, consolidated entities may, with prior authorisation by the Central Bank, exclude a subsidiary, provided that either of the following conditions is satisfied:

1. The company’s activities, irrespective of its purpose as stated in its Articles of Association, does not entail owning or trading any kind of securities, financial instruments other than securities, derivatives, currencies, or other assets.
2. The company is owned by a credit institution or subsidiary on the basis of Article 22 of the Act on Financial Undertakings, no. 161/2002, irrespective of whether it is a domestic or foreign company.

Authorisations according to Paragraph 5 shall be requested in writing and supported; they are granted only temporarily, for a maximum of 12 months, and expire automatically at the end of the period of validity.

Article 5

Foreign exchange balance

The foreign exchange balance of systemically important supervised entities shall be within the following limits at all times:

1. An open position in individual foreign currencies may be neither positive nor negative by more than the equivalent of 10% of a systemically important supervised entity's own funds; cf., however, Paragraph 4.
2. The total foreign exchange balance may be neither positive nor negative by more than the equivalent of 10% of a systemically important supervised entity's own funds — cf., however, Paragraph 4 — but may never exceed 25 b.kr.

The foreign exchange balance of a credit undertaking that is not a systemically important supervised entity shall be within the following limits at all times:

1. An open position in individual foreign currencies may be neither positive nor negative by more than the equivalent of 15% of the credit undertaking's own funds; cf., however, Paragraph 4.
2. The total foreign exchange balance may be neither positive nor negative by more than the equivalent of 15% of a credit undertaking's own funds — cf., however, Paragraph 4 — but may never exceed 25 b.kr.

Should the foreign exchange balance deviate from the limits set forth in Paragraphs 1 and 2, the credit undertaking concerned must take action so as to eliminate the difference within a maximum of three business days. If the undertaking's measures fail to achieve this, the Central Bank may calculate *per diem* fines on the amount by which the balance exceeds the stipulated limit, cf. Article 2, Paragraph 1 of the Rules on the Imposition of Periodic Penalty Payments, no. 389 of 29 May 2002.

The limits specified in Paragraphs 1 and 2 shall be calculated based on the capital base according to the credit undertaking's most recent financial statements. Credit undertakings are authorised to adjust the capital base at the end of the month to reflect exchange rate movements, provided that the Central Bank is notified explicitly of such changes. If this authorisation has been used, a corresponding adjustment upwards or downwards shall be made at the end of each month.

Credit undertakings shall also submit information on their total foreign exchange balance as a share of common Tier 1 equity (CET1) in monthly reports to the Central Bank of Iceland. This shall be based on CET1 according to the financial statements upon which the credit institution bases its calculations; cf. Paragraph 4.

Article 6

Reporting

Those parties to whom these Rules apply shall submit reports on their foreign exchange balance to the Central Bank on a monthly basis, as is specified in Article 3, cf. Article 4, no later than the fifteenth (15th) day of each month; however, the parent company of a consolidated entity shall submit a report on the consolidation no later than the twentieth (20th) day of each month. If the due date falls on a weekend or a holiday, the report shall be submitted on the business day immediately following.

The Central Bank of Iceland may demand more frequent reports than is specified here. At any time, the Central Bank may also request more detailed information on the itemisation of assets and liabilities in accordance with Article 3.

Market makers in the interbank foreign exchange market shall also submit daily reports on their foreign exchange balance. The report shall specify only the total current position of assets and liabilities, on the one hand, and the forward position of assets and liabilities, on the other.

If a credit undertaking neglects to submit this information to the Central Bank at the time specified in these Rules, the Bank may impose *per diem* fines on the financial undertaking concerned, according to the Rules on the Imposition of Periodic Penalty Payments, no. 389/2002.

Article 7

Entry into effect

These Rules are set in accordance with the authority contained in Article 13 of the Act on the Central Bank of Iceland, no. 36/2001, and Article 8 of the Foreign Exchange Act, no. 87/1992. The shall take effect on 30 August 2018. At that time, the Rules on Foreign Exchange Balance, no. 950 of 6 December 2010, shall be abrogated.

Temporary Provisions

Notwithstanding the provisions of Article 3, Paragraph 1, Items 10.a and 11.a of these Rules, as well as the provisions of the final sentence of Article 3, Paragraph 7 of these Rules, concerning, on the one hand, the itemisation of current assets according to whether loans are granted to borrowers unprotected against exchange rate risk, and on the other hand, the obligation to specify in reports those agreements that are made for the purpose of hedging by the counterparty, those parties to whom these Rules apply are authorised, until 1 January 2019 and upon prior consultation with the Central Bank, to conduct its reporting of these items in accordance with the available information in their information systems. No later than seven (7) business days before submitting their first report according to these Rules, these parties shall notify the Central Bank of how they intend to carry out the itemisation concerned, and the Central Bank may demand more detailed information; cf. Article 6, Paragraph 2 of these Rules.

Reykjavík, 17 August 2018

Central Bank of Iceland

Már Guðmundsson
Governor

Harpa Jónsdóttir
Director