

RULES

on Foreign Exchange Balance

With reference to Article 13 of Act No. 36/2001, on the Central Bank of Iceland, and to Article 8 of Act No. 87/1992 on Foreign Exchange, the Board of Governors of the Central Bank of Iceland has set the following rules on the foreign exchange balance of credit institutions subject to minimum reserve requirements and other authorised foreign exchange brokers.

Article 1

Scope

These rules apply to credit institutions subject to minimum reserve requirements, i.e. commercial banks and savings banks, cf. Act No. 113/1996 as amended, and to other credit institutions, cf. Act. 123/1993 as amended, which operate in Iceland. They also apply to parties authorised by the Central Bank to act as intermediaries in foreign exchange transactions under permits which oblige them to comply with rules on foreign exchange balance.

Article 2

Definitions

Exchange rate-linked items in these Rules comprise assets, liabilities and off-balance sheet items denominated in foreign currencies and items in Icelandic krónur which use an exchange rate reference.

The current position of a foreign currency comprises exchange rate-linked assets and liabilities in that currency, including current transactions to be settled within three business days.

The forward currency position comprises all exchange rate-indexed transactions to be settled after three or more business days.

An institution's open position in individual currencies comprises assets, liabilities and off-balance sheet items denominated in the respective foreign currency for which the institution itself bears the risk.

An institution's net foreign exchange balance is the sum of its positive open foreign exchange positions (net long position) less the sum of its negative open foreign exchange positions (net short position).

Equity capital in these Rules is, where applicable, as defined in the equity capital provisions of Act No. 113/1996, on Commercial Banks and Savings Banks, as amended, Act No. 123/1993 on Credit Institutions Other than Commercial Banks and Savings Banks, as amended, or Act No. 144/1994, on Annual Accounts, as amended. However, equity capital of Sparisjóðabanki Íslands hf. [Icebank] shall include the total of the letters of guarantee issued by individual savings banks in connection with the liabilities of Sparisjóðabanki Íslands hf. towards foreign credit institutions.

Article 3

Calculation of open foreign exchange position

The following exposures shall be included in calculations:

- 1) Net current position, i.e. all assets less liabilities including accrued interest which is not yet due. The loan loss reserve shall be deducted from assets.

- 2) Net forward position, i.e. the institution's exposure in forward rate agreements, futures and currency swaps, insofar as these agreements are not included in its net current position. Currency swaps shall be treated as an asset in one currency and as a liability in the other.
- 3) Irrevocable guarantees and similar commitments which are considered certain to be called and are unlikely to be recoverable.
- 4) Total net delta value of currency options. Institutions trading in options shall calculate the delta value in accordance with the provisions of [the Financial Supervisory Authority's] Rules No. 693/2001 on the Solvency Ratio of Credit Institutions and Undertakings Engaged in Securities Services.
- 5) Market value of other options denominated in foreign currency.
Institutions which have been specifically authorised to do so by the Financial Supervisory Authority (FME) may, further to the abovementioned items, take the following into account in evaluating their foreign exchange position:
 - 1) Unaccrued future income and expenses which are already fully hedged.
 - 2) Exposures made by the institution specifically to hedge against the adverse impact of changes in the exchange rate of a currency on its capital adequacy ratio, and shareholdings in subsidiaries which have been deducted from equity capital calculations. Such exposures may be exempted from evaluations of the foreign exchange position provided they are not of a commercial nor systematic nature.
In calculating the open position in individual currencies, basketed currency units must be broken down according to the weight of each component currency of which they are comprised.

Article 4

Foreign exchange balance

An institution's foreign exchange balance shall always be within the following limits:

- 1) An institution's open position in individual currencies may neither be long nor short by more than the equivalent of 15% of equity according to the most recently published financial statements. The balance for the US dollar and euro, however, may be long or short by 20%.
- 2) The sum of an institution's exposures in individual currencies may neither be long nor short by more than 30% of equity according to the most recently published financial statements.

Credit institutions with a balance exceeding the limits specified here shall take immediate measures to adjust it, and it shall be brought inside the permissible limits within three business days. If an institution's measures fail to rectify its foreign exchange balance within the said limits, the Central Bank may calculate periodic penalties, in accordance with Article 2, paragraph 1 of the current Rules on the Imposition of Periodic Penalty Payments, to be levied on the amount by which the balance exceeds the stipulated limit. Determination of periodic penalty payments, the right of appeal and collection are subject where appropriate to the provisions of Articles 6, 7 and 8 of the aforementioned Rules on the Imposition of Periodic Penalty Payments. The Bank may debit penalties from the current account of the institution in question a minimum of seven days after the party was notified of the decision to impose them, cf. Article 6, paragraph 3 of the said Rules.

Article 5

Reporting

Parties subject to these Rules shall submit monthly reports to the Central Bank in such a form as it decides. Reports shall be submitted within 10 business days from the end of each month. However, members of the interbank foreign exchange market shall submit daily reports, cf. the Rules in force on the foreign exchange market in this respect.

The Central Bank may impose periodic penalties for negligence in reporting in accordance with paragraph 1, as provided for under Article 2, paragraph 2 of the aforementioned Rules on the Imposition of Periodic Penalty Payments. Determination of periodic penalty payments, the right of appeal and collection are subject where appropriate to the said provisions, cf. Article 4, paragraph 2 above.

Article 6

Entry into force

These Rules enter into force on July 1, 2002. At the same time Rules No. 421 from July 1, 1997, on the Foreign Exchange Balance of Credit Institutions and Parties Authorised to Act as Intermediaries in Foreign Exchange Transactions, are abrogated.

Reykjavík, May 29, 2002
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