HONG KONG MONETARY AUTHORITY
香港金融管理局

Circulars

18 Oct 2000

Basel Committee on Banking Supervision: Supervisory Guidance for Managing Settlement Risk in Foreign Exchange Transactions

Our Ref : B1/15C

18 October 2000

The Chief Executive
All authorized institutions

Dear Sir / Madam,

Basel Committee on Banking Supervision: Supervisory Guidance for Managing Settlement Risk in Foreign Exchange Transactions

The Basel Committee on Banking Supervision has recently published a revised version of the above paper, after incorporating comments received on the consultative draft issued in July 1999.

The paper stresses that foreign exchange settlement risk is a form of credit risk that banks should manage, like other credit risks of a similar size and duration, through a formal process of measurement and control with active senior management oversight. I would draw your attention to paragraph 39 of the paper, which notes that the use of payment-versus-payment (PvP) settlement should significantly reduce the principal risk associated with FX settlement. As you will be aware, PvP settlement for foreign exchange transactions between US dollars and Hong Kong dollars is now available in Hong Kong via the respective Real Time Gross Settlement Systems and this facility should become still more attractive when arrangements for intra-day repos to fund the US dollar side become operational in December. Once again I would encourage authorized institutions to make use of this PvP facility as a means of reducing their FX settlement risk.

The HKMA is aware that in some cases use of the US$/HK$ PvP facility may require modifications to procedures and systems. In considering whether to make such modifications, institutions should take full account of the risk mitigation advantages that PvP settlement can bring, and bear in mind that other PvP systems are likely to emerge in due course. It would make sense, therefore, for institutions to ensure that their systems have sufficient flexibility to cope with these new developments, particularly with the choice which they introduce to settlement arrangements.

The paper can be downloaded from the BIS website (www.bis.org/publ/pub_list.htm). Also available are the revised versions of two other papers which will be of interest to authorized

institutions, Principles for the Management of Credit Risk and Best Practices for Credit Risk Disclosure.

Yours faithfully,

D T R Carse
Deputy Chief Executive

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