FORM DQ: QUARTERLY DERIVATIVES RETURN

Introduction

This return records reporting institutions' asset and liability positions in derivatives as at the end of the period. These data contribute to the UK National Accounts and Balance of Payments.

Updated in Statistical Notice 2014/05

~~Financial derivatives are defined as financial instruments that are linked to the price performance of an underlying and which involve the trading of financial risk. Examples of the underlying might include a financial instrument, commodity, bilateral foreign exchange rate, movement in stock index, or interest rate~~. **Financial derivatives are financial instruments that are linked to a specific financial instrument or indicator or commodity, through which specific financial risks can be traded in financial markets in their own right. The value of a financial derivative derives from the price of the underlying item: the reference price. The reference price may relate to a commodity, a financial asset, an interest rate, an exchange rate, another derivative or a spread between two prices. The derivative contract may also refer to an index or a basket of prices.** Financial derivatives include options, futures/forwards, swaps, **forward rate agreements (FRAs)**, caps, floors, collars, warrants and credit derivatives; they do not include spot foreign exchange trades. Where institutions are in doubt if a particular instrument constitutes a derivative, they should contact the Bank's derivatives analyst on 0207 601 ~~4450~~ **3067** or via ~~mfsd_derivs@bankofengland.co.uk~~ **srdd_derivs@bankofengland.co.uk** for guidance.

Scope of return

The form covers both OTC and exchange-traded contracts. Reporting institutions should include all contracts at their market or fair value, where the fair value is the amount at which the contract could be exchanged in an arm's length transaction between informed and willing parties. Contracts with a positive marked-to-market value should be recorded as an asset (claim); contracts with a negative marked-to-market value should be recorded as a liability.

Updated in Statistical Notice 2014/05

The form excludes contracts held with other areas of the reporting unit **but** ~~. It~~ can include contracts held with institutions which are part of the same group, provided the counterparty constitutes a separate institution. The defining point is whether or not the counterparty is included in the **statistical** returns of the reporting institution; if it is, then these contracts should be excluded from the return (see also paragraph ~~4~~ **3**(a) of the General Notes and Definitions).

Contracts should be included on the form if they ~~would~~ **should** appear on the balance sheet of the reporting institution, specifically on BT item 19B. ~~Where contracts are booked to a global centre, reporting institutions must take a view on whether this practice materially affects the balance sheets of their reporting unit and that of the global centre/contributing branch. Where settlement of contracts is effected by the global booking centre, this may be indicative that balance sheet positions should have the residency status of the centre. However, it is possible to imagine circumstances in which the residency status of balance sheet positions is ambiguous. Where this occurs, the Bank's derivatives analyst would welcome a discussion of your proposed treatment.~~ **Derivative contracts should be reported in line with other financial instruments, insomuch that a reporting institution should report an asset (or**

liability) if it receives the benefits (or is obliged to make payments) of a contract with another entity. Back-to-back trades that transfer the risks/benefits of a contract to another institution (or non-resident office) within the same group should be included on the form.

Netting of positions: Reporting institutions' asset and liability positions should generally be reported gross as set out in the General Notes and Definitions. Note, therefore, that positions in derivatives reported for statistical purposes may not be consistent with similar data being required for supervisory purposes. However, where exchange-traded contracts are regarded by the clearing houses as closed out due to the presence of exactly matched offsetting positions; such contracts should be excluded from this form.

Foreign currency translation: Non-sterling amounts are to be reported in sterling converted at end of period exchange rates. Please note that gold is considered to be a foreign currency rather than a commodity. As such, contracts involving gold should be considered as foreign currency contracts and should be reported accordingly; in particular, swap and forward transactions involving gold and another foreign currency should be reported according to their receive leg. All other metals are considered to be commodities, and should be reported accordingly.

Sections of return

The form is divided into three sections. A summary of each section follows.

Section One: Total positions analysed by sector

This captures the sum of positions reported in Section Two.

Section Two: Derivatives positions analysed by risk category under the appropriate product type and by sector

Updated in Statistical Notice 2014/05

All derivatives should be reported by risk type and by the economic sector of the counterparty, as well as by product type where appropriate. Exchange-traded derivatives should be recorded as having the clearing house as counterparty. Interest rate swap contracts between reporting institutions and the SwapClear facility operated by LCH.Clearnet Limited (formerly London Clearing House) should be reported in accordance with the sectoral classification of LCH.Clearnet Ltd, ~~that is, "UK financial corporations other than monetary financial institutions".~~ **which is classified as a "financial auxiliary" in the Classification of Accounts Guide, and should be reported in "financial corporations other than MFIs, insurance corporations and pension funds" on form DQ.**

Section Three: All cross-border derivatives positions by country

This is a breakdown by country of the non-resident data within Section One. For notes on the classification by country of business with non-residents, see the Classification of Accounts Guide Part III.~~12~~**10**.

More detailed guidance

Categorisation of contracts involving more than one market risk category

Individual derivatives are to be categorised into four market risk categories: foreign exchange, single currency interest rate, commodity/equity**/other** and credit derivative. In practice, derivatives may involve more than one category. In such cases the contract should be reported in only one category to avoid double counting, with the allocation being based on the underlying risk component which primarily determines the price of the contract. However, if for practical reasons reporting institutions are in doubt about the correct classification of multi-exposure derivatives they should allocate the deals according to the following order of preference.

- Credit derivatives: This category includes all instruments classed as credit derivatives. This applies regardless of any joint exposure to any other risk categories.

Updated in Statistical Notice 2014/05

- Commodity/Equity**/Other:** All derivative instruments with a commodities or commodities index exposure, or equities or equities index exposure, should be reported in this category. This applies even if the instrument involves a joint exposure to foreign exchange or interest rate risk. **Derivative instruments that have an exposure that cannot be categorised as credit, foreign exchange, interest rate, commodity or equity should also be reported in this category. Examples of "other" market risks include contacts whose exposure is linked to the weather, actuarial or other external factors not elsewhere classified.**
- Foreign exchange: This category will include all derivatives instruments (with the exception of those already reported as credit or commodity/equity derivatives) with exposure to more than one currency, be it in interest rates or exchange rates. It excludes spot foreign exchange transactions, which are not considered to be derivatives and should be excluded from this form. In the event that it is impossible to distinguish between spot and forward foreign exchange transactions, both should be included.
- Interest rate: For positions data this category will include derivatives instruments in which there is exposure to one, and only one, currency's interest rate. This category should include all fixed and/or floating single currency interest rate contracts including forwards, swaps and options.

Where institutions have doubts about the appropriate treatment, they should contact the Bank's derivatives analyst.

Margining

Repayable funds held in margin accounts should be excluded from this form. Where such funds are held as cash, they should be reported on Form BT as loans or deposits as appropriate. Where margin calls are covered by securities, no balance sheet change is required since the fact that the securities are held as collateral does not alter their balance sheet entry.

Collateral

Any amounts placed as **collateral** (cash or other assets) against exposures arising through derivatives should be excluded from this form.

Options

This includes both OTC and exchange traded options, as well as warrants. Interest rate caps, floors and collars should be reported as options in the interest rate risk category.

Outstanding values should be recorded at market value as set out in the General Notes and Definitions. Where an option has lapsed there is nothing to record.

Updated in Statistical Notice 2014/05

When the counterparties to **warrant contracts** are unknown, and cannot be estimated, it is acceptable to split the total warrant figures in an ~~80:20~~ **80:10:10** ratio between ~~"UK banks other than the Bank of England" and "UK Financial corporations other than MFIs"~~ **"UK banks (other than Bank of England) and building societies", "UK insurance corporations and pension funds" and "financial corporations other than MFIs, insurance corporations and pension funds".**

Futures and forwards

As noted above, spot foreign exchange trades should be excluded from this return. For the purpose of statistical returns, spot transactions are defined as ones where the time lag between agreeing the contract and delivery of the underlying is minimised, whereas forward transactions are ones where delivery is deliberately delayed. Forward forex deals are usually ones with an original maturity of three days or more. Foreign exchange futures or forwards should be allocated to the currency of the receive leg.

Swaps

Swaps should be marked to market in line with the instructions contained in the General Notes and Definitions. Single currency interest rate swaps should be allocated to sterling, Euro or foreign currency depending on the currency of the underlying notional. Swaps where the two legs are in different currencies should be allocated according to the currency of the receive leg.

Currency swaps where one of the payments streams varies with a floating interest rate (i.e. cross-currency swaps) should be recorded under the foreign exchange risk category.

Plain vanilla swaps involving an agreement to exchange periodic payments related to interest rates on a single currency, fixed for floating, or floating for floating based on different indices should be reported as interest rate swaps.

If principal amounts are exchanged at the end of the contract these amounts should be recorded as the realisation of one asset and the acquisition of another on the balance sheet (Form BT).

Forward Rate Agreements (FRAs)

The market value of the FRA should be reported as set out in the instructions within the General Notes and Definitions.

Credit derivatives

Reporting institutions should report positions arising through credit derivatives. International statistical standards regard instruments as credit derivatives rather than, say, insurance products or guarantees if they are recognisable as derivatives, tradeable or capable of being offset in the market, and capable of being given an arms-length value. Credit derivatives include total return products such as total return swaps and credit spread derivatives. They also include credit default products such as credit default options and credit default swaps. Where institutions have doubts about the definition, they should contact the Bank's derivatives analyst.

Other products

OTC products made up of several plain vanilla components should in principle be reported separately under the appropriate product heading. If, however, decomposition into individual "plain vanilla" components is impractical or impossible these contracts may also be classified as "other products".

Updated in Statistical Notice 2014/05

Embedded derivatives are those where a derivative contract is embedded within an underlying instrument. Where, in accordance with IAS 39, the two components are not closely linked in economic terms, the IAS guidelines require either the separation and fair valuation of the derivative or the fair valuation of the entire structured product. For statistical purposes, all embedded derivatives (if being reported separately from the host instrument), should be reported at market or fair value in Form DQ. Where the two components are closely linked in economic terms and separation is prohibited by IAS 39, the derivative contract should not be included on this form but should be included within the valuation of the underlying as reported on Form BT, and subject to the specific guidance applicable - refer to sections ~~8(b)~~ **7(b)** and ~~17(e)~~ **15(e)** of the General Notes and Definitions.