Guidelines on the treatment of structural FX under Article 352(2) of Regulation (EU) No 575/2013 (CRR)

(EBA/GL/2020/09)

These Guidelines are addressed to competent authorities as defined in point (i) of Article 4 (2) of Regulation (EU) No 1093/2010 and to financial institutions as defined in Article 4 (1) of Regulation No 1093/2010.

The Guidelines are intended to develop the treatment of structural foreign exchange positions in accordance with Article 352 (2) of Regulation (EU) No 575/2013 and have been drawn up on the EBA's own initiative. Specifically, these guidelines establish the procedural and substantive conditions, as well as the calculation and monitoring processes, that must govern the granting of the authorization of the exemption referred to in the aforementioned article.

These Guidelines have been developed by the EBA in accordance with article 16 of Regulation (EU) No 1093/2010. The EBA published the English version of these Guidelines on 1st July 2020 (the Spanish version was released on 28th August 2020).

The Executive Commission of the Banco de España, in its role of competent authority for the direct supervision of less significant credit institutions and specialised lending institutions, adopted these Guidelines as their own on 23rd October 2020, with immediate application.

EBA/GL/2020/09

1 July 2020

Guidelines

on the treatment of structural FX under Article 352(2) of Regulation (EU) No 575/2013 (CRR)

1. Compliance and reporting obligations

Status of these guidelines

1. This document contains guidelines issued pursuant to Article 16 of Regulation (EU) No 1093/2010[1]. In accordance with Article 16(3) of Regulation (EU) No 1093/2010, competent authorities and financial institutions must make every effort to comply with the guidelines.

2. Guidelines set the EBA view of appropriate supervisory practices within the European System of Financial Supervision or of how Union law should be applied in a particular area. Competent authorities as defined in Article 4(2) of Regulation (EU) No 1093/2010 to whom guidelines apply should comply by incorporating them into their practices as appropriate (e.g. by amending their legal framework or their supervisory processes), including where guidelines are directed primarily at institutions.

Reporting requirements

3. According to Article 16(3) of Regulation (EU) No 1093/2010, competent authorities must notify the EBA whether they comply or intend to comply with these guidelines, or otherwise with reasons for non-compliance, by 28.10.2020. In the absence of any notification by this deadline, competent authorities will be considered by the EBA to be non-compliant. Notifications should be sent by submitting the form available on the EBA website to compliance@eba.europa.eu with the reference 'EBA/GL/2020/09'. Notifications should be submitted by persons with appropriate authority to report compliance on behalf of their competent authorities. Any change in the status of compliance must also be reported to EBA.

4. Notifications will be published on the EBA website, in line with Article 16(3).

[1] Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC, (OJ L 331, 15.12.2010, p. 12).

2. Subject matter, scope and definitions

Subject matter

5. These guidelines provide guidance to competent authorities across the EU on the treatment of structural foreign exchange positions referred to in Article 352(2) of Regulation (EU) No 575/2013.

Scope of application

6. These guidelines apply with regard to requests for permission by institutions applying the requirements of Regulation (EU) No 575/2013 on an individual basis as well as to requests for permission by institutions applying the requirements of Regulation (EU) No 575/2013 on a consolidated basis. Where institutions request a permission at both these levels these guidelines apply separately at each level, even if the request for that permission is made at the same time.

7. These guidelines apply to all institutions, irrespective of whether they calculate the own funds requirements for foreign exchange risk in accordance with the standardised approach referred to in Title IV, Chapter 3 of Regulation (EU) No 575/2013 for all of their positions, or in accordance with the internal model approach referred to in Title IV, Chapter 5 of that Regulation for all of their positions, or based on one of these approaches for some of their positions and the other approach for the remaining positions.

Addressees

8. These guidelines are addressed to competent authorities as defined in point i of Article 4(2) of Regulation (EU) No 1093/2010 and to financial institutions as defined in Article 4(1) of Regulation No 1093/2010.

Definitions

9. Unless otherwise specified, terms used and defined in Regulation (EU) No 575/2013 have the same meaning in the guidelines.

3. Implementation

Date of application

10. These guidelines apply from 01.01.2022.

11. Competent authorities should review, update or revoke permissions already granted at the date of application of these guidelines.

4. Overview of requirements

12. For the purpose of granting the permission referred to in Article 352(2) of Regulation (EU) No 575/2013, the following process should be applied:

    (a) requests should meet the procedural admissibility requirements referred to in Section 5 and the substantive admissibility requirements referred to in Section 6;

    (b) any requests that are admissible in accordance with point (a), should then be assessed with the view to examining their compliance with the conditions of Regulation (EU) No 575/2013 in accordance with Section 7;

    (c) with regard to any requests that have been found compliant with the requirements of that Regulation in accordance with point (b), the size of the position to be excluded should be determined in accordance with Section 8.

13. Following the granting of the permission referred to in Article 352(2) of Regulation (EU) No 575/2013, the ongoing monitoring of the permission should be carried out in accordance with Section 9.

5. Procedural admissibility of a request under Article 352(2) of Regulation (EU) No 575/2013

14. Competent authorities should deem as acceptable the submission of more than one request for permission by an institution at the same time, including where such requests relate to different levels of application of the own funds requirements of Regulation (EU) No 575/2013 or to more than one foreign currency.

15. In their request to competent authorities, institutions should justify how the positions in the currency for which they seek the exemption meet the specifications set out in these guidelines. They should also specify:

    (a) the methodology that they intend to use in order to exclude the position from the net open position in the foreign currency where the own funds requirements for foreign exchange risk are calculated using the internal model approach in accordance with Title IV, Chapter 5 of Regulation (EU) No 575/2013;

    (b) the methodology that they use to calculate the own funds requirements for foreign exchange risk and the methodology they intend to use for removing the position for which they seek the exemption from the net open position, where they compute the own funds requirements of Regulation (EU) No 575/2013 for market risk on a consolidated basis without having the permission to offset positions in some institutions or undertakings in the group in accordance with Article 325 of that Regulation.

6. Substantive admissibility of a request under Article 352(2) of Regulation (EU) No 575/2013

Hedging of a ratio

16. An open position in a foreign currency should be considered to be hedging the ratio where it reduces the adverse effect on that ratio caused by changes in the exchange rate, irrespective of whether that adverse effect derives from an appreciation or a depreciation of that foreign currency with respect to the reporting currency and irrespective of whether the position is maintained for hedging the ratio or taken for hedging the ratio.

17. The request for the permission referred to in Article 352(2) of Regulation (EU) No 575/2013 should specify which of the three ratios referred to in Article 92(a), (b) and (c) of Regulation (EU) No 575/2013 the institution aims to hedge and the rationale for the selection of that ratio.

Currencies to which the hedging relates

18. The request by an institution to exempt positions should be made with regard to currencies that are relevant to the business of the institution.

19. For the purpose of paragraph 18, currencies that should be considered relevant to the business of the institution should be the five currencies for which the net open positions of the institution calculated in accordance with Article 352(1) of Regulation (EU) No 575/2013 are the largest.

20. Other currencies not meeting the condition referred to in paragraph 19 may be considered relevant where there is adequate justification supporting the relevance of the currency in the business of the institution.

21. Where an institution seeks the permission referred to in Article 352(2) of Regulation (EU) No 575/2013 with regard to positions in more than one relevant currency, both of the following should apply:

    (a) the same ratio as that referred to in paragraph 17 should be selected in the context of each of such currencies;

    (b) where calculating the maximum net open position referred to in paragraph 31 in the context of one currency, the institution should do it as if no waivers were granted for other currencies in accordance with Article 352(2) of Regulation (EU) No 575/2013 for positions in other currencies.

Positions eligible to be exempted

Non-trading book nature

22. A position in the foreign currency stemming from an item that is held in the trading book should not be considered as eligible to be exempted.

Long nature of the hedging position

23. In order for a position in a foreign currency to be considered eligible to be exempted, the numerator of the ratio hedged by that position should increase where the relevant foreign currency appreciates with respect to the reporting currency.

24. In order for a position in a foreign currency to be considered eligible to be exempted, that position should be net long at the level at which the institution computes the own funds

requirements for market risk in accordance with Regulation (EU) No 575/2013. Where the institution computes the own funds requirements on a consolidated basis, paragraphs 25 and 26 also apply.

25. Where the institution computes the own funds requirements of Regulation (EU) No 575/2013 for market risk on a consolidated basis without having the permission referred to in Article 325 of Regulation (EU) No 575/2013, and the position is net short at the level of one or more of the institutions within the group, the position in those institutions should be managed for the sole purpose of hedging the ratio to be considered eligible for the exemption.

26. Where the institution computes the own funds requirements of Regulation (EU) No 575/2013 for market risk on a consolidated basis having the permission referred to in Article 325 of Regulation (EU) No 575/2013, and the position is net short at the level of either any subsets of institutions in the group within which the positions are offset as specified in that permission, or at the level of any other of the institutions within the group which are not included in that permission, the position in those subsets of institutions or in the other institutions outside the permission should be managed for the sole purpose of hedging the ratio to be considered eligible for the exemption.

7. Examination of the merits – assessment of the structural nature of the positions and of the intention to hedge the ratio

Assessment of the structural nature of a position

27. The following positions should be considered as positions of a structural nature:

    (a) where the institution requesting the permission referred to in Article 352(2) of Regulation (EU) No 575/2013 applies the requirements of that Regulation on an individual basis, a position in the relevant currency which corresponds to investments in subsidiaries that are included in the same scope of consolidation as the institution requesting the permission;

(b) where the institution requesting the permission referred to in Article 352(2) of Regulation (EU) No 575/2013 applies the requirements of that Regulation on a consolidated basis, a position for which both of the following conditions are met:

  (i) it stems from an investment in a subsidiary that has been included in the consolidation;

  (ii) the currency of the position coincides with the reporting currency used by the subsidiary holding the item to which such position corresponds.

28. Other positions not meeting the conditions referred to in paragraph 27 could be considered of a structural nature where there is an adequate justification that should be built considering the following:

(a) whether those positions are related to the cross-border nature of the institution;

(b) whether those positions are related to a business of the institution which is consolidated and stable over time;

(c) how the institution plans to manage those positions over time.

Assessment of the intention to hedge the ratio – governance and risk management strategy of the structural positions

29. In order for the competent authorities to be able to establish that the position in the relevant currency has been taken or is maintained for the purpose of hedging the relevant ratio, all of the following conditions should be met:

(a) the institution operates and documents the risk-management framework for managing such positions;

(b) the risk management framework referred to in point (a) sets out the objective to hedge the ratio from movements in the exchange rate over time and provides for its assessment by means of both quantitative measures and qualitative criteria;

(c) the risk management framework referred to in point (a) specifies a maximum acceptable level of tolerance for the sensitivity of the ratio with respect to changes in the exchanges rate and specifies in detail the criteria and methodology for setting such a level of tolerance. Criteria for setting the level of tolerance should encompass all components that may lead to a change in the value taken by the sensitivity and any specificity of the currency;

(d) the risk management framework referred to in point (a) includes a limit of the maximum loss that is deemed acceptable for the institution to incur due to the choice of maintaining the positions for which the permission referred to in Article 352(2) of Regulation (EU) No 575/2013 is sought;

(e) the risk management framework referred to in point (a) is linked to the risk-appetite framework of the institution and the overall risk management of the institution and any relevant documents that have been approved by the senior management or the board of the institution;

(f) in the risk management framework referred to in point (a) there is an explicit warning that the open position that is maintained for hedging the ratio will lead to losses as soon as the relevant currency depreciates, and that hedging the ratio leads to an increase in the volatility of the own funds due to changes in the relevant exchange rate;

(g) the risk management framework referred to in point (a) and the documentation describing it, is approved by the management board of the institution;

(h) the risk management framework referred to in point (a) specifies a strategy for achieving the objective referred to in point (b), which includes at least the following:

   (i) it outlines the definition of the boundaries between positions that the institution categorises as structural and taken with the purpose of hedging the ratio and those that are not, and requires that such boundaries are used by the institution where taking a new position in the relevant currency;

   (ii) it states the positions the institution intends to open or close for the purpose of meeting the objective referred to in point (b);

   (iii) it requires the documentation of evidence for both of the following:

      - that opening or closing those positions does not lead to any inconsistency with the overall risk management of the institution or with the risk management that any entity within the scope of the consolidation may apply on an individual basis;

      - that opening or closing those positions is consistent with the risk management frameworks that any entity within the scope of consolidation may have where applying the provision in Article 352(2) of Regulation (EU) No 575/2013 for the purpose of hedging ratios at another level of consolidation;

(iv) where applicable, it describes how positions that have been taken with the only purpose of hedging the ratio in accordance with paragraphs 25 and 26 are managed in order to meet the objective referred to in point (b);

(i) the strategy referred to in point (h) has a time horizon of at least six months;

(j) the documentation describing the risk management framework referred to in point (a) includes all of the following:

(i) it outlines the data and capital figures that are used for computing the quantitative measures referred to in point (b) and the maximum net open position referred to in paragraph 31;

(ii) where the institution took some positions with the sole purpose of hedging the ratio in accordance with paragraphs 25 and 26, it includes evidence that those positions were taken with that purpose only;

(iii) it describes the simplifications that are made for the purpose of computing the maximum net open position and the analysis of the effect of such simplifications on the value taken by that maximum net open position in accordance with paragraph 31, by providing at least a gap analysis showing that the simplifications made do not lead to an overestimation of the maximum net open position.

8. Size of the position to be excluded

30. The size of a position to be excluded in accordance with Article 352(2) of Regulation (EU) No 575/2013 should be determined in accordance with the following process:

(a) by first calculating the maximum net open position in the relevant currency, in accordance with paragraph 31;

(b) by then comparing the size of the structural position that the institution has taken for hedging the ratio and, depending on the size of that position, applying either paragraph 33 or paragraph 34.

31. The institution should calculate the maximum net open position in accordance with the following formulas:

(a) where the institution aims at hedging the CET1 ratio, in accordance with the following formula:

$$MaxOP_{FC} = CET1 \cdot \frac{\frac{RWA_{NoFX_{FC}}(1.01 \cdot FX_{FC}) - RWA_{NoFX_{FC}}(FX_{FC})}{0.01 \cdot FX_{FC}}}{RWA_{NoFX_{FC}}(FX_{FC})}$$

where:

FC = the currency of the structural position;

$MaxOP_{FC}$ = the maximum net open position expressed in the foreign currency FC;

$CET1$ = the Common Equity Tier 1 of the institution expressed in the reporting currency;

FX_{FC} = the spot exchange rate between the reporting currency and the foreign currency FC of the structural position;

$RWA_{NoFX_{FC}}(.)$ = the total risk exposure amount expressed in the reporting currency calculated in accordance with Article 92(3) of Regulation (EU) No 575/2013, excluding the own funds requirements for foreign exchange risk for all positions that are in the foreign currency FC;

(b) where the institution aims at hedging the Tier 1 ratio, in accordance with the following formula:

$$MaxOP_{FC} = T1 * \frac{\frac{RWA_{NoFX_{FC}}(1.01 \cdot FX_{FC}) - RWA_{NoFX_{FC}}(FX_{FC})}{0.01 \cdot FX_{FC}}}{RWA_{NoFX_{FC}}(FX_{FC})} - AT1_{FC}$$

where:

FC = the currency of the structural position;

$MaxOP_{FC}$ = the maximum net open position expressed in the foreign currency;

$T1$ = the Tier 1 capital of the institution expressed in the reporting currency;

FX_{FC} = the spot exchange rate between the reporting currency and the foreign currency FC;

$RWA_{NoFX_{FC}}(.)$ = the total risk exposure amount expressed in the reporting currency calculated in accordance with Article 92(3) of Regulation (EU) No 575/2013, excluding the own funds requirements for foreign exchange risk for all positions that are in the foreign currency FC;

$AT1_{FC}$ = the value derived in accordance with the following formula:

$$AT1_{FC} = \frac{V_{AT_1}(1.01 \cdot FX_{FC}) - V_{AT_1}(FX_{FC})}{0.01 \cdot FX_{FC}}$$

where:

V_{AT_1} = the value of the portfolio expressed in the reporting currency constituted by all Additional Tier 1 instruments issued by the institution;

(c) where the institution aims at hedging the total capital ratio, in accordance with the following formula:

$$MaxOP_{FC} = OF * \frac{\frac{RWA_{NoFX_{FC}}(1.01 \cdot FX_{FC}) - RWA_{NoFX_{FC}}(FX_{FC})}{0.01 \cdot FX_{FC}}}{RWA_{NoFX_{FC}}(FX_{FC})} - AT1_{FC} - T2_{FC}$$

where:

OF = the own funds of the institution expressed in the reporting currency;

$MaxOP_{FC}$ = the maximum net open position expressed in the foreign currency;

$RWA_{NoFX_{FC}}(.)$ = the total risk exposure amount expressed in the reporting currency calculated in accordance with Article 92(3) of Regulation (EU) No 575/2013, excluding the own funds requirements for foreign exchange risk for all positions that are in the foreign currency FC of the structural position;

FX_{FC} = the spot exchange rate between the reporting currency and the foreign currency FC of the structural position;

$AT1_{FC}$ = the value derived in accordance with the following formula:

$$AT1_{FC} = \frac{V_{AT1}(1.01 \cdot FX_{FC}) - V_{AT1}(FX_{FC})}{0.01 \cdot FX_{FC}}$$

where:

V_{AT1} = the value of the portfolio expressed in the reporting currency constituted by all Additional Tier 1 instruments issued by the institution;

$T2_{FC}$ = the value derived in accordance with the following formula:

$$T2_{FC} = \frac{V_{T2}(1.01 \cdot FX_{FC}) - V_{T2}(FX_{FC})}{0.01 \cdot FX_{FC}}$$

where:

V_{T2} = the value of the portfolio expressed in the reporting currency constituted by all Tier 2 instruments issued by the institution.

32. Institutions may apply simplifications when calculating the maximum net open position in accordance with paragraph 31 only where they meet both of the following conditions:

    (a) they are able to show the effect of such simplifications on the value of the maximum net open position;

    (b) the effect of the simplifications referred to in point (a) does not represent an overestimation of the maximum net open position.

33. Where the size of the position that the institution has taken for hedging the ratio is lower than the maximum net open position, the whole structural position should be excluded from the calculation of the net open position.

34. Where the size of the position that the institution has taken for hedging the ratio exceeds the maximum net open position, only the portion of that structural position which corresponds in size to the maximum net open position should be excluded from the calculation of the net open position.

35. Positions corresponding to non-monetary items that are held at historical cost, items that have been deducted from the institution's own funds and items that may lead to gains or losses that do not impact the CET1 capital should not be considered for the purpose of paragraph 33 and paragraph 34 and should be excluded from the calculation of the net open position in addition to the position that has been excluded in accordance with those paragraphs.

9. Ongoing monitoring of the permission

36. Institutions should perform the calculation of the maximum net open position at least monthly. Competent authorities may request institutions to compute the maximum net open position and the sensitivity at any time.

37. For each of the currencies for which institutions have the permission from the competent authority to exclude some positions from the corresponding net open position, institutions should calculate the following figures on a monthly basis and report them to the competent authority on a quarterly basis:

(a) the net open position in the currency previous to any permission;

(b) the net open position stemming from positions in the currency that are not structural;

(c) the size of the net open position that is structural and which has been taken for hedging the ratio;

(d) the maximum net open position ($MaxOP$) calculated in accordance with paragraph 31;

(e) both of the following sensitivities:

(i) $sensitivity_1 = \frac{S\_OP - MaxOP_{FC}}{RWA_{NoFX_{FC}}}$

where:

S_OP = the size of the net open position in the foreign currency that is structural and that the institution has taken for hedging the ratio, excluding positions corresponding to any of the following items:

- items that have been deducted from the institution's own funds;

- non-monetary items that are held at historical cost;

- items that may lead to gains or losses that do not impact the CET1 capital in accordance with Regulation (EU) No 575/2013;

$MaxOP_{FC}$ = the maximum net open position calculated in accordance with paragraph 31;

FC = the currency of the structural position;

$RWA_{NoFX_{FC}}$ = the total risk exposure amount calculated in accordance with Article 92(3) of Regulation (EU), excluding the own funds requirements for foreign exchange risk for all positions that are in the foreign currency FC;

(ii) the sensitivity of the capital ratio with respect to changes in the exchange rate as calculated by the institution;

(f) a qualitative assessment stating the reasons for any changes in the amount of the net open position referred to in point (c) and the values taken by the two sensitivities referred to in point (e);

(g) the spot exchange rate between the reporting currency and the foreign currency FC on the reference date;

(h) any planned changes relating to the request to the competent authority;

(i) the percentage of total credit risk-weighted amounts in the foreign currency to the total risk-weighted amounts of the institution.