Single Rulebook Q&A

Question ID	2020_5294
Status	Final Q&A
Legal act	Regulation (EU) No 575/2013 (CRR)
Topic	Credit risk
Article	114
Paragraph	7
Subparagraph	-
COM Delegated or Implementing Acts/RTS/ITS/GLs/Recommendations	Not applicable
Article/Paragraph	NA
Date of submission	08/06/2020
Published as Final Q&A	24/09/2021
Disclose name of institution / entity	No
Type of submitter	Credit institution
Subject matter	Risk weight for the credit risk of third countries with supervisory and regulatory arrangements at least equivalent to those applied in the Union according to Article 114(7) CRR
Question	If an institution has an exposure to a third country which has supervisory and regulatory arrangements at least equivalent to those applied in the Union (such as Turkey) but do not have fully corresponding liabilities denominated in that currency to cover the entire exposure, what risk weight for the credit risk should assigned to the exposure of this country?

Background on the question	As per Q&A 3262 relating to an institution's exposure towards the Turkish central government, in order for an institution to assign to those exposures a lower risk weight - which is determined by the relevant Turkish competent authorities - those exposures need to be denominated in the Turkish currency, and at the same time the institution needs to have corresponding liabilities denominated in that currency. If an institution has corresponding liabilities in the same currency that partially covers the total exposure to the central government, it is unclear whether only that partial amount would be allowed to have the lower risk weight. For example, if an institution has an exposure of 100 to the Turkish government, in the Turkish currency, but only have liabilities of 30 in the same currency on their balance sheet, it is unclear whether the institution can apply a lower risk weight, as determined by the relevant Turkish competent authorities, to 30 of the exposure and then apply the higher risk weight to the remaining exposure of 70.
EBA answer	As clarified in Q&A 3262, the treatment described in Article 114(7) CRR can be applied to exposures towards central governments and central banks of third countries, which apply supervisory and regulatory arrangements at least equivalent to those applied in the Union, provided that the exposure is denominated and funded in the third country currency. This last requirement allows eliminating the risk of losses because of movements in foreign exchange rates. Splitting an exposure into parts to apply different prudential treatments to them is only accepted under the standardised approach for credit risk when the legal text explicitly allows it. For instance, Article 124(1) allows splitting exposures secured by mortgages on immovable properties and assigning the parts to different exposure classes under specific circumstances; and Article 193(5) permits subdividing an exposure into parts that are covered by different types of credit risk mitigation techniques for risk weighting purposes. Article 114 does not contain any provision that allows splitting the exposure into different parts. Therefore, the treatment under Article 114(7) can only be applied when the whole exposure towards the third country central government or central bank is denominated and funded in the third country currency.
Link	https://www.eba.europa.eu/single-rule-book-qa/qna/view/publicId/2020_5294