Single Rulebook Q&A

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Status	Final Q&A
Legal act	Regulation (EU) No 575/2013 (CRR)
Topic	Credit risk
Article	114
Paragraph	4
Subparagraph	-
COM Delegated or Implementing Acts/RTS/ITS/GLs/Recommendations	Not applicable
Article/Paragraph	N/A
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Disclose name of institution / entity	No
Type of submitter	Competent authority
Subject matter	Preferential risk weight for exposures to central governments and central banks under Article 114(4) of CRR
Question	Does Article 114(4) of CRR apply to both on-balance sheet and off-balance sheet liabilities (including the forward leg of an FX swap) in the same domestic currency and at least the same amount as the exposure to the central government or central bank (on- or off- balance sheet exposures)?
Background on the question	Due to the limited nature of Basel and EU guidance provided to-date, in particular the specificities of the case discussed by Q&A 2018_3832, the general rule about what may constitute "funding" for the purpose of Article 114(4) CRR remains unclear. CRE20 of the Basel Framework explains in a footnote to the term "funded" under the corresponding provision to Article 114(4) of CRR that "[…] the bank would also have corresponding liabilities denominated in the domestic currency." The Basel Discussion Paper on the Regulatory Treatment of Sovereign Exposures (December 2017) also explains that "historically, the requirement to fund domestic-currency sovereign exposures in the same currency as the exposure in orderto qualify for a preferential risk weight was aimed at mitigating foreign exchange risk. In practice, the Committee noted that funding sources are somewhat fungible and not necessarily linked to specific assets." Putting together both

	Basel provisions, we understand that “corresponding” refers to the amount rather than the source of domestic currency funding for the purposes of Article 114(4) of CRR. Q&A 2018_3832 explains that the preferential treatment provided for by Article 114(4) of CRR “shall be applied only to exposures to Member States' central governments and central banks denominated and funded in the same currency. It shall not be therefore extended to exposures denominated and funded in different currencies also in case these are combined with an FX Swap hedging the FX risk.”
Final answer	The meaning of “funding” under Article 114(4) CRR should be read to include both on-balance sheet and off-balance sheet liabilities (including any currently existing liability in the domestic currency in question constituted by an initial leg of an FX swap once an actual exchange of the respective currencies has taken place at the beginning of the transaction) in the same domestic currency and at least the same amount as the exposure to the central government or central bank (on- or off- balance sheet exposures). The meaning of “funding” for this purpose does not include liabilities that might only materialize in the future (either contingent liabilities or potential liabilities from derivatives). Consequently, “funding” for this purpose does not arise from FX swaps where no actual exchange of the respective currencies takes place at the beginning of the transaction (e.g. where the only payment made is the final settlement for occurred differences in exchange rates). For the avoidance of doubt, Q&A 3832 addresses the situation where the purpose of an FX swap is just to hedge the FX risk, with no actual exchange of the respective currencies at the beginning of the transaction.
Link	https://www.eba.europa.eu/single-rule-book-qa/qna/view/publicId/2022_6439

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