Single Rulebook Q&A

Question ID	2013_248
Status	Final Q&A
Legal act	Regulation (EU) No 575/2013 (CRR)
Topic	Own funds
Article	486
Paragraph	4
Subparagraph	-
COM Delegated or Implementing Acts/RTS/ITS/GLs/Recommendations	Not applicable
Article/Paragraph	n/a
Date of submission	13/09/2013
Published as Final Q&A	06/12/2013
Disclose name of institution / entity	No
Type of submitter	Competent authority
Subject matter	Determination of the appropriate currency to be used for calculating the base for grandfathering and phase-out limits
Question	Can the base for grandfathering and phase out limits be calculated in the currency that the instrument eligible for grandfathering is denominated in?
Background on the question	On the basis of the formula given in Article 486(4) of Regulation (EU) No 575/2013 (CRR), the institution calculates the base to which phased-out limits refer, the so-called 'base for grandfathering'. Over the next 10 years this base will be used to calculate the maximum amount of subordinated debt that can be classified as Tier 2 despite its non-compliance with criteria set out in Article 63. Due to the fact that the institution's subordinated instruments are denominated in CHF in order to avoid the volatility of the maximum amount (resulting from fluctuations in foreign exchange rate CHF/PLN), the base shall be denominated in CHF. The reason for this is that the subordinated debt was issued to finance mortgage loans also granted in CHF. This 'natural hedge' reduces the volatility of the capital adequacy ratio. However, when the base for grandfathering is fixed in the bank's reporting currency (PLN), the benefit of this 'natural hedge' is eliminated. In such a case although the Tier 2 capital as well as capital charge are calculated in reporting currency, so that they co-move together with FX rate fluctuations,

	the absolute limit for grandfathering is fixed and does not change with FX rate movements.
EBA answer	The effects of the so called “natural hedge” should already be recognised in the income statement and therefore the fixing of the maximum amount as of 31 December 2012 should be done in the functional currency, which is normally the local currency, at the year-end middle exchange rate as required under accounting rules (see IAS 21). Otherwise, the transitional rules would have to be split-up for each currency used, which would be overly complex and work against the flexibility originally provided for institutions by applying the maximum amount to classes of capital instead of single instruments. Finally, using a stronger currency as a basis could lead to higher amounts to be recognised given the fact that the stronger currency could perform better in relation to functional currency.
Link	https://www.eba.europa.eu/single-rule-book-qa/-/qna/view/publicId/2013_248

European Banking Authority, 27/01/2022
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