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# Guidelines

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

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# 1. Executive Summary

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The concept and specific application of the structural foreign exchange (FX) provision pursuant to Article 352(2) of Regulation (EU) No 575/2013 (the Capital Requirements Regulation, CRR) is subject to several interpretations, across both supervisory authorities and institutions. This is particularly relevant as over the last few years institutions appear to have become increasingly interested in the application of the structural FX exclusion. In addition, the implementation of this provision has proved to be quite uneven across jurisdictions, and there is a lack of clarity around what constitutes a structural position for the purposes of Article 352(2). Finally, the treatment of the structural FX has been modified in the recently published Fundamental Review of the Trading Book (FRTB).

In order to ensure a harmonised EU interpretation and implementation of the treatment of structural FX positions, the EBA is publishing these guidelines on how to implement the structural FX provision contemplated in Article 352(2) of the CRR.

The EBA published a discussion paper (DP) on 22 June 2017<sup>1</sup> to gather feedback on current stakeholder practice and interpretation of the structural FX provision, and to provide the EBA's preliminary views on the topic. The DP aimed to elicit discussion and gather stakeholders' opinions at an early stage of the process. The DP outlined the EBA's preliminary views regarding the rationale and mechanics behind the structural FX provision, which allows competent authorities to authorise, on an ad hoc basis, the exclusion of FX positions of a 'structural nature', provided they have been taken on purpose to function as a hedge of the capital ratio(s). The DP outlined the rationale behind the structural FX treatment and, without pre-empting any conclusions, discussed several general elements that need to be considered by institutions and competent authorities when assessing this provision, such as (i) the limitation of types of FX positions, (ii) the maximum size of the position to be potentially excluded and (iii) the consideration of the minimum CRR levels for the capital ratio. Apart from these general elements, the DP provided a more detailed initial assessment of the specific cases where the exclusion of an FX position may be justified from an economic perspective.

On 16 October 2019, the EBA published a consultation paper<sup>2</sup> on which these guidelines are based. Twenty-one respondents provided feedback on the consultation paper. However, only six of the responses were non-confidential and were published on the EBA website. A summary of the non-confidential responses, along with the EBA analyses of those responses, is available at the end of this document. The EBA considered the feedback provided by all respondents in developing this final draft.

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<sup>1</sup> <https://eba.europa.eu/documents/10180/1888124/Discussion+Paper+on+the+treatment+of+structural+FX+%28EBA-DP-2017-01%29.pdf>

<sup>2</sup> <https://eba.europa.eu/regulation-and-policy/market-risk/guidelines-on-the-treatment-of-structural-fx-under-352-2-of-the-crr>

The guidelines are deemed to set objective criteria that competent authorities should consider for the purpose of assessing whether the conditions set out in Article 352(2) for receiving the permission are met, while granting a balanced degree of flexibility. In this context, in order to harmonise practices among EU jurisdictions, several technical details have been included as part of these guidelines.

These guidelines are structured as follows:

- Section 2.1 provides some clarifications around the structural FX provision. In particular, it is clarified that (i) institutions may apply for the waiver for any of the three ratios mentioned in Article 92, (ii) institutions computing the own funds requirements for FX risk both using the standardised approach and using the internal model approach may apply for the waiver and (iii) the waiver should be sought only for currencies that are relevant to the institution.
- Section 2.2 discusses the concepts of positions ‘deliberately taken to hedge the capital ratio’<sup>3</sup> and positions of ‘a non-trading or structural nature’. Accordingly, some minimum requirements based on these two notions are set out. In particular, the guidelines set out that only banking book positions may be subject to the waiver (upon meeting other conditions) and that the position for which the exemption is sought should be long on a net basis.
- Section 2.3 lays down the governance requirements and the requirements related to the risk management strategy of the institution with respect to its structural FX positions. Specifically, the EBA identified (i) ‘types’ of FX positions for which there is a presumption of their structural nature and (ii) criteria aimed at assessing whether the institution is actually taking a position for the purpose of hedging the ratio.
- Section 2.4 deals with the treatment of items held at historical cost. In this context, the EBA clarified that such items should be considered part of the FX open position. In addition, given that the value of those items is not impacted by small changes in the exchange rate, an ad hoc treatment has been specified with respect to their exemption under the structural FX provision.
- Section 2.5 deals with the calculation of the maximum open position that can be excluded from the net open position. In line with the FRTB standards, the EBA clarifies that the exemption should be limited in size by the open position for which the capital ratio is non-sensitive to the exchange rate.
- Section 2.6 clarifies some aspects of the calculation of the own funds requirements for FX risk where some positions have been excluded from the net open position following

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<sup>3</sup> In this document, the terms ‘capital ratio’ and ‘ratio’ are used as generic terms to refer to the three ratios included in Article 92 of the CRR (i.e. Common Equity Tier 1 (CET1) ratio, Tier 1 ratio and total capital ratio).

the permission of the competent authority, e.g. how institutions calculating the own funds requirement with the internal model approach are expected to exclude the FX positions for which they receive the exemption.

- Section 2.7 provides some clarifications around the approval process and how competent authorities should react to possible changes in the risk management strategy of structural FX positions. It also details the reporting requirements for ensuring appropriate ongoing monitoring of the waiver.
- Finally, two annexes are included to further clarify some technical details discussed in the sections above and to provide examples around the application of the structural FX provision.

Considering that these guidelines introduce for the first time a detailed regulatory framework around the structural FX provision, they will be applicable only from 1 January 2022 to give institutions enough time to comply with the new requirements.

## 2. Background and rationale

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1. The structural FX provision in Article 352(2) of Regulation (EU) No 575/2013 (CRR) is subject to various interpretations that have led to differences in its application both in EU Member States and across institutions. In order to ensure a harmonised approach, the EBA has produced these own-initiative guidelines on the practical implementation of the 'structural FX' provision contemplated in Article 352(2) of the CRR.

2. It is important to note that, even if these guidelines relate to the provision included in Article 352(2), which refers to the current market risk framework, they have been developed also considering changes to the market risk framework introduced in the revised Capital Requirements Regulation (CRR2), which builds on the new FRTB standards published by the Basel Committee on Banking Supervision (BCBS) in January 2019, and taking into account the structural FX treatment envisaged in those standards.

3. It should also be noted that these guidelines have been designed so that institutions (or competent authorities) will not be required to request (or grant) a new permission once institutions switch from the current framework to the FRTB framework for computing the own funds requirements for market risk.

### 2.1 Overview of the provision and clarifications on the application of the structural FX treatment

4. This section provides an overview of the regulatory treatment of the structural FX provision in the CRR and clarifies some aspects around its applicability.

5. Article 352(2) of the CRR states that:

*Any positions which an institution has deliberately taken in order to hedge against the adverse effect of the exchange rate on its ratios in accordance with Article 92(1) may, subject to permission by the competent authorities, be excluded from the calculation of net open currency positions. Such positions shall be of a non-trading or structural nature and any variation of the terms of their exclusion, subject to separate permission by the competent authorities. The same treatment subject to the same conditions may be applied to positions which an institution has which relate to items that are already deducted in the calculation of own funds.*

6. The provision allows competent authorities to authorise, on an ad hoc basis, the exclusion of FX risk positions deliberately taken by firms to hedge against the adverse effect of exchange rates on capital ratios from the calculation of the net open currency positions, where those positions are of

a non-trading or structural nature. For the convenience of the reader, 'structural positions' refer to positions for which the institution seeks the permission referred to in Article 352, which, following the assessment of the competent authority, are considered to be of a non-trading or structural nature.

7. It is worth mentioning that, in the context of these guidelines, a position that has been taken to hedge the ratios against the adverse effect of changes in the FX rate on its ratios is a position that reduces the volatility of the ratios with respect to changes in the relevant exchange rate. Accordingly, such positions should limit the changes in the value of the ratios considering both appreciations and depreciations of the foreign currency with respect to the reporting currency. Therefore, such positions should limit the changes in the value of the ratios compared with a closed position.

8. In line with these guidelines, the assessment of the competent authority should lead to the identification of the positions that are *suitable for the exemption*, i.e. the positions that the competent authority assesses to be structural and that were taken for the purpose of hedging the ratio. Once the positions that are suitable for the exemption have been identified, all or some of these positions are excluded from the net open position in line with these guidelines.

9. It is worth clarifying that the FX position or the FX risk position means the FX risk stemming from any item/asset/liability held by the institution. Accordingly, what is subject to the exemption is the FX risk position stemming from an item/asset/liability, not the item/asset/liability itself.

10. The fact that a position is structural does not necessarily mean that it is suitable for the exemption. The institution should always prove that a structural position has been taken for the purpose of hedging the ratio. Accordingly, there can be structural positions that are not suitable for the exemption.

#### Maximum open position that can be exempted under the structural FX provision

11. These guidelines clarify that the open position that can be exempted under the structural FX provision is capped by the open position neutralising the sensitivity of the capital ratio to changes in the exchange rate. Accordingly, in these guidelines, we refer to the maximum open position or maximum net open position as the open position neutralising the sensitivity of the capital ratio to changes in the exchange rate (under certain assumptions discussed in Section 2.5)<sup>4</sup>.

12. The methodology that institutions should use for calculating the open position neutralising the sensitivity of the capital ratio to movements in the exchange rate is discussed in Section 2.5.

13. There might be cases where the size of the open position generated by positions that are suitable for the exemption (and therefore potentially exemptible from the net open position)

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<sup>4</sup> In particular, it should be understood that, since when calculating the maximum open position, the size of the position that will be exempted is not known some assumptions need to be made about what capital ratio to consider for the purpose of determining such a maximum open position. All such assumptions are discussed in Section 2.5.

exceeds the maximum open position that can be exempted. Accordingly, these guidelines set a clear distinction between FX positions that cannot be exempted because they are not suitable for the exemption (e.g. because they are not structural or because they are not taken for hedging the ratio) and FX positions that are not exempted only because of the cap imposed by the maximum open position.

14. These guidelines refer to over-hedges, where the position suitable for the exemption is greater in size than the maximum open position (i.e. the position perfectly hedging the ratio). Similarly, in under-hedges, the position suitable for the exemption is lower in size than the maximum open position.

#### Ratios to which the structural FX provision applies

15. Article 352(2) of the CRR refers to the ratios of the institutions, as defined in Article 92(1). Article 92(1) defines (i) the Common Equity Tier 1 (CET1) ratio, (ii) the Tier 1 (T1) ratio and (iii) the total capital ratio and sets their minimum levels required. Therefore, it seems to be open to interpretation which of the ratios should be the target for the hedge.

16. Accordingly, these guidelines were developed considering that institutions may apply for the waiver when hedging any of the three ratios introduced in Article 92(1) with structural FX positions. Because the CET1 ratio is the ratio that attracts the most attention from external stakeholders, the expectation of the EBA would be that the CET1 ratio is the ratio that institutions should aim to hedge.

17. A position that is suitable for the exemption in the context of the structural FX provision applied to one ratio of the institution is also deemed suitable for the exemption in the context of the structural FX provision of another ratio of the institution.

18. Where the institution perfectly hedges the total capital ratio, the T1 ratio and the CET1 ratio are over-hedged. Along the same lines, where the institution perfectly hedges the CET1 ratio, the T1 ratio and the total capital ratio are in general under-hedged. It is clear that the FX open position required to neutralise the sensitivity of the ratio to the FX rate depends on the ratio that the institution hedges. Accordingly, the number of FX positions that could be exempted from the net open position (i.e. recognised as structural) varies from ratio to ratio (as the maximum open position that can be exempted varies).

19. As a result of the previous paragraph, if the institution were calculating the maximum open position for each of the ratios, it would also obtain different own funds requirements for each of the ratios (as the positions that can be exempted would differ in size). To prevent such a situation from occurring, these guidelines specify that the institution should choose the ratio it intends to hedge and, accordingly, develop a strategy with the purpose of hedging such a ratio.

20. Once the exemption has been granted by the competent authority in the context of one ratio, it will have an impact on all three reported ratios due to the reduction in risk weights for FX risk.



21. The guidelines also clarify that the ratio to be considered when computing the maximum open position is the current ratio, i.e. the ratio that the institution currently has (or the one calculated with the latest available figures), and not any form of ratio the institution plans to have or foresees having in the future. Accordingly, competent authorities should assess whether the FX risk positions hedge the current capital ratio and potentially grant the permission to exclude them from the net open position.

22. As specifically mentioned in Section 2.3, institutions are required to justify the choice of ratio. In addition, the EBA thinks that institutions should disclose such information to investors, clearly indicating that keeping open a position could possibly lead to losses (even where such a position is kept open with the purpose of hedging the ratio).

#### Structural FX: provision for more than one currency

23. Article 352(2) refers to the adverse effect of the exchange rate between the reporting currency and any other currency. Accordingly, an institution may request permission to exclude from the relevant net open positions FX risk positions in more than one currency. However, these guidelines clarify that permission should be sought (and potentially granted) for currencies that are relevant to the business of the institution. In particular, positions in a currency that is not material (or relevant) for the institution should not be considered to be deliberately taken for hedging the ratio from the corresponding exchange rate; indeed, movements in such an exchange rate would negligibly affect the ratio.

24. These guidelines take as a premise that the top five currencies of the business of the institution are material. However, there might be other currencies that are actually relevant for the institution, e.g. when the institution performs its business in several countries with different currencies. Accordingly, the institution may also ask for the permission referred to in Article 352(2) for positions in currencies that are not among the top five; however, when doing so, the institution is required to justify the relevance of the currency for the institution, e.g. the justification may be based on the cross-border nature of the business performed by the institution.

25. For the purpose of the previous paragraph, the top five currencies are the five currencies corresponding to the largest net open positions calculated in accordance with Article 352(1), without considering any waiver.

26. The EBA acknowledges that identifying the most material currencies with an absolute threshold may not be risk sensitive. However, as mentioned above, institutions are in any case also allowed to request the permission for currencies that are not among the top five. In this context, the EBA preferred to have in place a simple approach rather than a risk-sensitive approach to identify those currencies for which there is a presumption of materiality.

27. These guidelines also reflect the possibility of institutions applying for the structural FX treatment for more than one currency. In particular, as detailed in Section 2.5, it is specified that:

(1) When calculating the maximum open position for a specific currency for which it seeks the waiver, the institution should not consider any exemption that has already been granted for FX positions in other currencies under the structural FX provision.

(2) It should be noted that, where the institution applies for a waiver in several currencies (i.e. for more than one currency) in the same application, the institution should calculate the maximum open position per currency without considering any waiver that could be granted for the other currencies in the same process.

(3) The capital ratio hedged (i.e. CET1, T1 or total capital ratio) by the institution should be the same for different currencies.

The provision included in points (1) and (2) aims to limit the possibility of regulatory arbitrage; in particular, without such provisions, institutions would obtain a different size of maximum open position depending on the sequence (of currencies) they use when calculating the size of the maximum open position in the context of one currency<sup>5</sup>.

### Example:

*An institution reporting in EUR applied in the past for the structural FX treatment for its positions in GBP. The institution seeks now the waiver for its positions in USD and HUF.*

*Accordingly, when calculating the maximum open position that can be exempted in USD, the institution should not consider the exemption that has already been granted for FX-positions in GBP. Moreover, it should not consider any exemption that might be granted for positions in HUF.*

*Consistently, when calculating the maximum open position that can be exempted in HUF, the institution should not consider the exemption that has already been granted for FX-positions in GBP. Moreover, it should not consider any exemption that might be granted for positions in USD.*

*Point (3) requires the institution to calculate the maximum open position that can be exempted in GBP, USD, HUF considering the same type capital ratio.*

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<sup>5</sup> For example consider a bank that is reporting in EUR and applying the structural FX provision for positions in GBP and USD. If the institution calculates the maximum open position (i.e. the position offsetting the sensitivity of the ratio to the relevant exchange rate) for GBP positions and then for USD positions, then when calculating the maximum open position in GBP, the bank cannot consider the effect of any waiver for its position in USD (since the maximum open position in USD has not been calculated yet it is not possible to determine the size of the waiver). Afterwards, the institution calculates the maximum open position for USD positions, and it could do so by considering the effect of the waiver received for GBP positions. If the institution were calculating the two maximum open position in the opposite sequence (i.e. first for its positions in USD and then for its positions in GBP), it would get different results.

### Level to which the structural FX provision applies

28. Article 6 of the CRR determines that institutions shall comply with their market risk requirements on an individual basis, and Article 11 of the CRR establishes the obligation to comply with these requirements on a consolidated basis. Accordingly, institutions have to generally comply with the CRR requirements for market risk, including FX risk requirements, both on an individual and on a consolidated basis. Consequently, the waiver in Article 352(2) could apply both on an individual and on a consolidated basis.

29. These guidelines clarify that the structural FX provision applies on both an individual and a consolidated basis. A specific request should be sent to the competent authority for each level at which the institution seeks permission to apply the structural FX treatment. The need for a specific permission is because positions that have been taken for hedging the capital ratio at a consolidated level might not have a hedging effect on the capital ratio at a solo level (and vice versa). Accordingly, positions that might be exempted in one context might not receive the same prudential treatment (i.e. the exemption) in another context.

### Structural FX provision: standardised and internal model regulatory frameworks

30. An additional element of the current regulation related to FX positions that may be worth clarifying stems from the differences between the standardised and the internal model regulatory frameworks. The treatment of structural FX is established in Article 352, which is located in Title IV, Chapter 3 of the CRR. This chapter deals with the FX treatment under the standardised rules. Importantly, the same article also specifies the requirements for the calculation of the 'net foreign exchange position'.

31. In this regard, it is worth noting that there are no specific rules in the internal model part of the CRR (Chapter 5) regarding the calculation of the net FX position or the possible exclusion of structural FX, as any part of an institution's internal model is subject to approval by the competent authority. In any case, any permission granted for the net open position in the currency under the standardised approach can easily be applicable in the context of the internal model approach. These guidelines specify that institutions using the internal model approach for computing the own funds requirements for FX risk are required to specify in their waiver application how they will exclude the structural position from their net open position.

32. Accordingly, these guidelines reflect the fact that the exemption is available regardless of the approach followed by the institution to capitalise market risks. In this context, it is worth mentioning that the new standards on the minimum capital requirements for market risk published in January 2019 clarified that the structural FX treatment is available regardless of the approach implemented by institutions.

## 2.2 Positions ‘deliberately taken to hedge the capital ratio’ and positions of ‘a non-trading or structural nature’

33. As previously mentioned, the structural FX provision allows competent authorities to authorise, on an ad hoc basis, the exclusion of FX ‘positions’ deliberately taken by firms to hedge against the adverse effect of the exchange rate on capital ratios from the calculation of the net open positions, where those positions are of a non-trading or structural nature.

34. The EBA is of the view that the provision has a rather limited scope of application, as the hedging activity must be ‘deliberately taken in order to hedge against the adverse effect of the exchange rate on its ratios in accordance with Article 92(1)’. Specifically, this is fundamentally different from hedging specific exposures and would indicate that only positions taken to hedge the overall FX risk of the capital ratios, i.e. at the level of the overall balance sheet of the institution, can be taken into consideration. In addition, Article 352(2) of the CRR states that ‘such positions shall be of a non-trading or structural nature’.

35. As mentioned, the CRR requires the structural FX positions to be deliberately taken in order to hedge the ratio. These guidelines reflect the interpretation that, when considering whether or not a position is ‘deliberately taken’, this could be seen as analogous to ‘deliberately not closed’ or ‘maintained’. Accordingly, the guidelines have been developed with the overarching concept that structural FX positions are positions that have been taken or maintained (i.e. not closed) with the purpose of hedging the ratios of the institution.

36. Competent authorities are expected to assess (i) whether a position is of a structural (or non-dealing) nature and (ii) whether it has been taken to hedge the ratio. Whether a position is suitable for the exemption is strictly related to the way that the position is managed over time and accordingly it would be counterintuitive to, for example, define a specific set of conditions that structural positions should meet to be automatically identified as such without taking into account the risk management strategy of such positions (which is typical of the institution).

37. Accordingly, the risk management strategy of the structural FX positions, and the governance requirements set out in Section 2.3, are expected to constitute the basis for the assessment of the conditions in (i) and (ii) of the previous paragraph.

38. As mentioned, these guidelines do not include a list of requirements that, if all met, automatically identify a position as suitable for the exemption; however, they identify minimum requirements that, when not fulfilled, indicate that a position is not suitable for the exemption.

39. For the purpose of introducing such minimum requirements this section is divided into two subsections. In particular:

- the first subsection introduces minimum requirements in relation to the ‘structural or non-dealing nature’ of the positions for which the institution seeks the waiver;

- the second subsection introduces minimum requirements regarding the condition that the position for which the exemption is sought is kept for hedging the ratio.

### 2.2.1 Minimum requirements for being a position of a 'structural or non-dealing nature'

40. This section defines a first set of minimum requirements that positions should fulfil to be recognised as structural. It is important to stress that the fulfilment of these requirements does not entail that a position is of a structural (or non-dealing) nature. Indeed, whether a position is of a structural (or non-dealing) nature will be assessed by the competent authority in line with the reasoning in paragraph 36.

#### Limitation to banking book positions

41. These guidelines exclude the possibility of institutions including in the scope of positions suitable for the exemption FX positions that stem from instruments in the trading book. In other words, only banking book positions qualify as possibly being recognised as structural.

42. In particular, it is deemed that an FX risk position is of a non-trading nature only if the instrument from which it stems is of a non-trading nature as well. In addition, Article 102 of the CRR requires positions in the trading book to be free of restrictions (or able to be hedged). It is clear that, if a position stemming from the trading book could be among the scope of those for which the institution seeks the permission, then the position would automatically become subject to restrictions with respect to its tradability (as the institution would be required, for example, to keep that position until the item bearing the position expires).

43. Accordingly, it is deemed that only FX positions stemming from instruments for which the institution does not have trading intent (i.e. instruments held in the banking book) can possibly qualify for the exemption<sup>6</sup>. It should be noted that this does not automatically imply that banking book positions are structural; indeed, the structural nature of a position should always be assessed by the competent authority (in accordance with these guidelines).

44. It should be noted that the CRR requires institutions to include in the trading book positions for which they have a trading intent. Regardless of the nature of the financial instruments, and, in particular, regardless of their accounting treatment, institutions should include instruments that are taken for hedging the ratio and for which they do not have a trading intent in the non-trading book. For example, an institution may hedge the ratio by means of derivatives that, according to the business model of the institution, will be kept until maturity. In this case, the competent authority should not force the institution to book those instruments in the trading book just on the basis that those instruments are allocated to the trading book in the accounting framework.

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<sup>6</sup> It should be noted that the FRTB standards clarify that positions should be of a 'structural (i.e. non-dealing) nature', meaning that 'structural' and 'non-dealing' should be treated as synonymous.

### 2.2.2 Minimum requirements for an open position to be considered to be taken for hedging the capital ratio

45. This section sets out minimum requirements that the open structural position should fulfil to be recognised as being taken for hedging the ratio. It is important to stress that the fulfilment of such requirements does not entail that a position is actually suitable for being exempted. Indeed, whether the open structural position has been taken (or is maintained) for hedging the ratio will be assessed by the competent authority, considering also all other requirements included in these guidelines.

#### Long nature of the open FX position

46. If the purpose of structural FX positions is the hedging of the capital ratio, it is clear that only a net long FX position could potentially qualify for the exemption. Indeed, if an institution maintains a net short position, the effect on the numerator of the ratio of the fluctuations in the exchange rate will actually go in the reverse direction from the effect of the FX movement on the denominator of the ratio, exacerbating the effect of FX movements on the ratio compared with a closed position, which is the opposite of what would justify the application of the rule (i.e. hedge the capital ratio).

#### Example:

Parent bank (or subsidiary) reporting in EUR

Assets (converted in EUR)		Liabilities and Equity (converted in EUR)	
Loans in EUR	680	Liabilities in EUR	605
Loans in USD	20	Liabilities in USD	30
		CET1	65
Total assets	700	Total liab&equity	700

*Considering now a 10% appreciation in the foreign currency, the balance sheet of the institution would be:*

Parent bank (or subsidiary) reporting in EUR – after a 10% appreciation of the foreign currency

Assets (converted in EUR)		Liabilities and Equity (converted in EUR)	
Loans in EUR	680	Liabilities in EUR	605
Loans in USD	22	Liabilities in USD	33
		CET1	64
Total assets	702	Total liab&equity	702

*Accordingly, CET1 (i.e. the numerator of the ratio) diminishes, while the risk-weighted asset (RWA) for credit risk augments (and the FX- own funds requirements, as well as the open position, increases). As a result, the numerator and denominator of the ratio move in opposite directions, obtaining the opposite effect from a hedge.*

*It is worth mentioning that the numerator and denominator will also move in the opposite direction if the foreign currency depreciates.*

47. It is worth highlighting that, for the purpose of the waiver, it is the net open position that must be a long one. In turn, any net long position will normally be composed of gross long and gross short positions.

48. In accordance with the two paragraphs above, the guidelines set out that the position for which the institution seeks the exclusion from the net open position should constitute a net long FX position.

49. Below, the requirement to have a long position is detailed under three different cases: (A) where the permission is sought at a solo level, (B) where the permission is sought at a consolidated level, with Article 325 granted for all entities in the group, and (C) where the permission is sought at a consolidated level, with Article 325 not granted for some entities in the group.

#### **Case A: permission sought on an individual basis**

50. When the institution applies for the structural FX provision on an individual basis, then the exemption is meaningful when:

- (i) the net open position in the currency without exemption is long;

- (ii) the net open position generated by the exempted structural FX positions is long.

51. The net open position generated by the exempted structural FX positions should be long in the light of the reasoning in paragraph 46. Accordingly, the net open position in the currency before the exemption should also be long; if such a position were (net) short, then the exclusion of a long open structural position stemming from that net short position would actually increase the magnitude of the net open short position that the institution would have to capitalise.

52. However, considering that there is a natural incentive for institutions to fulfil the requirement in point (i) of paragraph 50<sup>7</sup>, these guidelines do not include other minimum requirements reflecting this aspect. As a result, when the provision is applied on an individual basis, the only requirement set out in this section is the one in point (ii) of paragraph 50 (i.e. the open structural position is long).

53. It should be noted that, to ensure that the structural FX provision is applied in a meaningful way (i.e. that the numerator and the denominator move in the same direction), a provision requiring the numerator of the ratio to increase when the foreign currency appreciates has also been included in the legal text.

**Case B: permission sought on a consolidated basis, with the permission in Article 325 granted for all entities**

54. When the permission is sought on a consolidated basis and the permission to offset the positions among all entities within the group has been granted, all rationales presented under Case A hold. Accordingly, also in this case, the only requirements set out in this section are that the open structural position is long and the numerator increases when the foreign currency appreciates.

**Case C: permission sought on a consolidated basis, with the permission in Article 325 not granted for some entities**

55. First, in this context, it is important to observe that the permission in Article 325 does not affect the calculation of CET1/T1/own funds of the institution at a consolidated level, as it deals only with the calculation of the own funds requirements (i.e. the denominator of the ratio). Accordingly, the CET1/T1/own funds of an institution are calculated regardless of the permission. As a result, the numerator of the capital ratio is sensitive to the exchange rate regardless of whether the permission in Article 325 has been granted or not.

56. Whether the permission in Article 325 has been granted or not does change, however, the own funds requirement for market risk (and accordingly also the FX charge) included in the denominator. In the feedback from the consultation, the EBA was asked to clarify how institutions should calculate the net open position when the permission referred to in Article 325 has not been

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<sup>7</sup> If the institution excluded a long position from a short position, the institution would get an even shorter position to consider for capitalisation (i.e. the capital requirements would increase following the exclusion).



granted. Although the EBA acknowledges that the level 1 text may leave some room for interpretation around this aspect, it decided not to address this specific point in these guidelines, as it goes beyond their scope; indeed, the provision would also be relevant to institutions not even applying for the structural FX waiver. As a result:

- (i) the EBA will investigate the possibility of addressing this issue using either a Q&A or any other tool that fits the purpose;
- (ii) groups not having the permission under Article 325 to offset positions in all institutions within the group are required to specify how they compute the own funds requirements for FX risk and to clarify how they plan to remove the positions from the net open position if the waiver will be granted.

57. The hedging effect that a position has on the ratio does not depend on whether the permission to offset the positions within the group has been granted or not. For example, the parent bank of a group may enter into a short position to reduce the size of a long position stemming from a subsidiary and in this way reduce the sensitivity of the consolidated ratio with respect to changes in the exchange rate. Such a hedging effect is present regardless of whether the permission in Article 325 has been granted or not. This situation is represented in the following example.

*Example:*

Parent institution at solo level reporting in EUR:

	Value in EUR		Value in EUR
Assets in EUR	700	Liabilities in EUR	595
Assets in GBP – participation	10	Liabilities in GBP	30
		CET1 in EUR	85

Subsidiary at the solo level reporting in GBP:

	Value in EUR		Value in EUR
Assets in GBP	300	Liabilities in GBP	225
		CET1 in GBP	75

Institution at a consolidated level reporting in EUR:

	Value in EUR		Value in EUR
Assets in EUR	700	Liabilities in EUR	595
Assets in GBP	300	Liabilities in GBP	255
		CET1 in EUR	150

Suppose that the bank entered into a short position at the parent level (EUR 30 in GBP) to reduce the over-hedge<sup>8</sup> that the bank would have without such a position. Then, a short position has been actually taken for hedging the ratio and the hedging effect is present regardless of whether the permission in Article 325 has been granted or not<sup>9</sup>.

58. As a result, the structural FX position also has to be long on a net basis under case C. When assessing whether the structural position is net long, institutions should net all positions that are structural regardless of the fact that the permission in Article 325 has been granted.

59. As mentioned later in this background section, the EBA believes that positions that are of a structural nature are mostly positions related to the cross-border nature of the group. This is in line with the feedback received by the EBA on the consultation paper on the proposed guidelines. The EBA expects the structural position stemming from a subsidiary to be net long (as in the example included above); thus, structural positions that are net short are expected to be present only at the parent bank level for the purpose of reducing the size of the long position stemming from the subsidiary – furthermore, the EBA expects this to happen only where the currency of the short position at the parent level is the same as the reporting currency of the subsidiary at the solo level. In other words, the EBA expects that a short position at the parent level is recognised as structural and taken for hedging the ratio if it is booked for the purpose of covering the translation risk that emerges when translating the positions stemming from the subsidiary.

60. In general, when the permission in Article 325 has not been granted (or only partially granted), the guidelines specify that a short position at the solo level (i.e. at subsidiary level or parent bank level) can be considered for the exemption at consolidated level only if it has been taken with the sole purpose of hedging the ratio at the consolidated level<sup>10</sup>. In addition, when the permission in Article 325 has not been granted, these guidelines require institutions to specifically describe how they manage positions that at the solo level are short for the purpose of hedging the ratio at a consolidated level.

<sup>8</sup> Over-hedge meaning that the net open position is greater than the position perfectly hedging the ratio.

<sup>9</sup> This is specified in the legal text by clarifying that the net open position has to be net long at the level at which the institution applies the CRR, i.e. at the level of the group (i.e. netting all positions in the foreign currency within the group).

<sup>10</sup> As explained, such short position must be in any case part of a long structural position at consolidated level.

61. Two other examples are provided below to show how the requirements described under case C work in practice.

*Example:*

*An institution is composed of three entities, P, S1 and S2, where P is the parent bank and S1 and S2 are two subsidiaries. Suppose that after applying for the permission in Article 325 the institution (i.e. P + S1 + S2) is allowed to offset positions in P and S1, but not S2. Then these guidelines set out that:*

*(i) the institution is allowed at a consolidated level to request the structural FX permission if the structural position for which the exemption is sought is net long at a consolidated level (i.e. netting all structural positions in P, S1 and S2);*

*(ii) supervisors should check whether the structural position is net long or net short at these levels:*

- 1. at the level of P + S1 – the positions among them can be netted;*
- 2. at the level of S2.*

*If at either of the two levels the structural FX position is short, then competent authorities are required to thoroughly check the reason why this is the case. As mentioned, the EBA expects that positions recognised as structural and taken for hedging the ratio should not be short at the level of S2. In addition, at the level of P + S1 a short position is expected to be recognised as structural only if it has been taken to reduce a long position that stems from the subsidiary S2 and if it is in the reporting currency of S2 (i.e. the risk at the consolidated level stems from the translation of positions held in S2 in the reporting currency used at the consolidated level).*

*Example:*

Parent bank at solo level reporting in EUR:

	Value in EUR		Value in EUR
Assets in EUR	700	Liabilities in EUR	595
Assets in GBP – participation	40	Liabilities in USD	30
		CET1 in EUR	115

Subsidiary at the solo level reporting in GBP:

	Value in EUR		Value in EUR
Assets in GBP	300	Liabilities in GBP	260
Assets in USD	60	Liabilities in USD	10
		CET1 in GBP	90

Institution at the consolidated level reporting in EUR:

	Value in EUR		Value in EUR
Assets in EUR	700	Liabilities in EUR	595
Assets in GBP	300	Liabilities in GBP	260
Assets in USD	60	Liabilities in USD	40
		CET1 in EUR	165

*Suppose that the institution is requesting the structural FX permission for all positions that are in USD, and that the institution does not have the permission under Article 325 to offset the positions held in the two entities. The position for which the exemption is sought in this case meets the minimum requirement to be net long (EUR 20 in USD).*

*However, at the level of P, the position for which the exemption is sought is short. In addition, this position was not taken to cover the risk stemming from positions that are not attracting FX risk at the individual level (i.e. the positions in GBP). As a result, the competent authority should check, for example, why the institution does not directly reduce its long position in USD at the level of the subsidiary, instead of taking a short position at the parent bank level, i.e. the competent authority should deeply investigate whether that short position has been taken for hedging the ratio and whether the institution could reach the same objective in a sounder way from a prudential point of view.*

## 2.3 Requirements related to the governance and risk management strategy for structural FX positions

62. This section sets out the governance requirements and the requirements related to the risk management strategy of the institution for its structural FX positions. As previously mentioned, the risk management strategy for structural FX positions and the governance requirements are expected to constitute the basis for the assessment performed by the competent authority.

63. When seeking the application of the waiver, institutions should specify in the application sent to the competent authority:

- (a) the level(s) of consolidation at which the exemption is sought;
- (b) which ratio among the three in Article 92 the institution intends to hedge, with a justification for the choice;
- (c) the currency/currencies of the positions for which the institution seeks the exemption;

64. In line with the level of consolidation and the currency of the positions for which the exemption is sought, the institution should specify in the application the FX positions that according to the institution are suitable for the exemption (and for which accordingly it seeks the exemption). All other positions must be considered non-structural by default.

65. In addition to the basic requirements mentioned in the previous paragraphs, the institution should fulfil the requirements outlined in the subsections below. In particular:

- The first subsection sets out requirements meant to support the competent authority in determining whether a position is of a structural nature.
- The second subsection deals with the requirements that the risk management strategy should fulfil. Such requirements have been designed to support supervisors in determining whether an FX position is of a structural nature and mainly to assess whether the structural open position is maintained, with the purpose of hedging the ratio.
- The third subsection introduces minimum requirements regarding the treatment of positions that have been recognised as suitable for the exemption (by the competent authority). Although this subsection deals with requirements that apply only once the exemption is granted, they are included in this part of the guidelines as they may play a significant role in the way the institution sets up the risk management of its structural FX positions.

### 2.3.1 **Categorisation of the positions for which the institutions seek the exemption**

66. For the positions for which the exemption is sought, institutions should indicate whether they are positions of type A or positions of type B in accordance with the specifications in the paragraphs below. Positions of type A are positions for which there is the presumption that they are of a structural nature, while positions of type B are positions for which a deeper analysis to assess the structural nature is needed.

67. The categorisation into positions of type A or positions of type B is meant to support the competent authority in analysing the application of the institution; in particular, such categorisation

is meant to support supervisors in assessing whether the conditions that positions should meet for being suitable for the exemption are actually met, and represents a minimum level of granularity into which such positions need to be subdivided by the institution.

68. The categorisation into positions of type A or positions of type B is based both on the EBA's view that positions that are of a structural nature are mainly positions related to the cross-border nature of the group and on the finalised FRTB standards (published in January 2019). In addition, this interpretation is in line with the feedback received on the consultation paper on the proposed guidelines.

69. It is important to stress that the classification of a position as type A (or type B) does not automatically imply that a position is of a structural (or of a non-structural) nature. In addition, being of a structural nature is only one of the conditions set out in these guidelines for a position to be exempted (e.g. even a net short position can be of a structural nature, but as described in a previous section such a position cannot be exempted).

70. Given that the classification does not entail any automaticity with respect to the structural nature of a position, among positions of type A there might be positions that the competent authority may not deem structural and for which the exemption is not granted. Similarly, there might be positions of type B that are actually structural and for which the competent authority may grant the permission (e.g. the typical case would be for positions stemming from branches whose set-up is similar to that of a subsidiary).

71. Following consultation, the EBA decided to also make explicit in the legal text that positions of type B could be part of the waiver to avoid the incorrect interpretation of the text. In particular, for positions of type B institutions are required to provide an adequate justification of the structural nature of the positions; high-level principles on which such a justification should be based are provided in the guidelines.

72. It is worth mentioning that, since the categorisation is performed only for positions for which the exemption is sought, the categorisation itself is meaningful/relevant only for the positions for which the minimum requirements discussed in Section 2.2 are met. All positions not meeting such minimum requirements are indeed considered to be non-structural (as previously set out).

#### **Case A: permission sought on an individual basis**

73. Where the provision is applied on an individual basis, except for investments in subsidiaries (i.e. investments in subsidiaries that are subject to prudential consolidation according to Title II, Chapter 2 of the CRR at the consolidated level), these guidelines do not identify any other kind of position that is clearly correlated with the cross-border nature of the group.

74. Accordingly:

- 1) **positions of type A:** investment in a subsidiary;

2) **positions of type B:** the remaining FX positions (i.e. FX positions that are not of type A).

75. It is worth mentioning that investments in the subsidiary are in general held at historical cost and accordingly they are subject to an ad hoc treatment in relation to the maximum open position, as presented in the following sections.

**Case B: permission sought on a consolidated basis**

76. Where the provision is applied at the consolidated level:

1) **positions of type A** are FX positions satisfying both conditions (a) and (b) below:

(a) the FX position stems from an investment in the subsidiary;

(b) the subsidiary holding the item from which the FX position stems has a reporting currency that coincides with the currency of the FX position itself;

2) **positions of type B:** the remaining FX positions (i.e. FX positions that are not of type A).

77. For meeting the accounting requirements, where consolidating or combining the financial statements prepared in different currencies, an institution must have financial statements of its foreign subsidiaries translated into its reporting currency in order to produce single-currency consolidated financial statements. The translation of assets and liabilities of the subsidiary may give rise, in the consolidated financial statements, to translation reserves. Movements of the exchange rate will affect the translation reserve through other comprehensive income (OCI), resulting in the volatility of the capital with no impact on the volatility of the profit and loss (P&L).

78. From a prudential perspective, all positions in the banking book and in the trading book (regardless of whether the corresponding gains or losses due to change in the exchange rate go through OCI or P&L in the financial statements) are subject to own funds requirements for FX risk.

79. However, in the context of the structural FX provision, it should be noted that, although there are exceptions, positions for which the institution seeks the exemption contributing to the translation reserve are expected to be positions of type A, as in general they fulfil the conditions for being classified as such. In line with paragraph 72, classification as positions of type A or type B is relevant only for positions that meet the minimum requirements set out in the previous sections; accordingly, without any exception, i.e. even if contributing to the translation reserves, trading book positions should not be considered structural.

80. FX positions of type A are positions not bearing FX risk when the own funds requirements are computed at the level of the subsidiary holding the items from which the FX positions stem.

Example 1:

*The institution consists of the parent bank P reporting in EUR and the subsidiary S reporting in GBP at individual level.*

*The parent bank P (at the solo level) has positions only in EUR, except for the long-term participation in the subsidiary, which is held at historical cost.*

*The subsidiary S has positions only in GBP.*

*At the solo level, neither of the two banks is subject to FX risk (except for the item held at historical cost by the parent bank); however, at the consolidated level the positions stemming from the subsidiary are subject to FX risk.*

*At the consolidated level, the FX positions in GBP stemming from the subsidiary are positions of type A.*

Example 2:

*Bank C is a subsidiary of bank B, and bank B is a subsidiary of parent bank A, and the reporting currencies of the three banks are different (e.g. EUR for bank C, GBP for bank B, USD for bank A). At a consolidated level, the positions in the foreign currency of C (i.e. EUR) are due to positions stemming from investments of A in B, which invested in C; accordingly, at the consolidated level the open position in the foreign currency of C (i.e. EUR) is generated by positions of type A.*

### **2.3.2 Risk management strategy of the positions for which the institutions seek the exemption**

81. This subsection deals with the requirements the risk management strategy should fulfil. Such requirements have been designed to support supervisors in determining whether an FX position is of a structural nature, and mainly to assess whether the structural open position is maintained with the purpose of hedging the ratio.

82. In particular, the notion ‘deliberately taken to hedge’ specifies that the credit institution must have entered into (or maintains) a position with the purpose and objective of hedging its ratio against the effects of exchange rate movements. Any requirement that is based on the intention is, however, challenging for the competent authorities to assess. For that purpose, a number of qualitative and quantitative elements have been put in place to assess whether a position is taken (or maintained) for the purpose of hedging the ratio.

83. For the purpose of assessing such requirements, institutions must provide supervisors with the business strategy used for the management of structural FX positions. In particular, the waiver application should refer to those documents in which the institution describes the intention and



the strategy to hedge the capital ratio. This will be first and foremost the institution's risk appetite framework (RAF), although other relevant documents approved by the board or senior management of the institution could also be considered. In particular, the institution should include in the waiver application only elements that are reflected in (or are consistent with) the institution's general risk management strategy.

84. In general, the risk management framework of the structural FX positions must be approved by the management board. In the approval process the members of the management board must be explicitly made aware that the open position that is taken/maintained for hedging the ratio will lead to losses (i.e. reduction in the own funds) when the foreign currency depreciates. In other words, the management board must be aware that a strategy that fully hedges the ratio entails higher volatility of own funds/CET1 amounts due to changes in the exchange rate than a closed position. In addition, a maximum limit on the loss that is deemed acceptable should be part of the approval from the management board.

85. In particular, the documentation describing the risk management framework should state:

- (i) the definition of the objective of the institution leading to the reduction of the sensitivity of the capital ratio to movements in the relevant exchange rate;
- (ii) the strategy to achieve that objective<sup>11</sup>, which should be outlined in a detailed, credible and reliable way, and the time horizon of this strategy, which should be at least 6 months.

86. It is worth highlighting that, for the purpose of receiving the structural FX waiver, the institution is not requested to fully offset the sensitivity of the ratio to changes in the exchange rate. The EBA fully acknowledges that institutions may have strategies that are, for example, based on a trade-off between having the ratio fully hedged (i.e. the sensitivity of the ratio to exchange rate changes is equal to zero) and zero volatility in CET1 due to the FX changes (i.e. according to the CRR this is equivalent to a net open position equal to zero, as per Article 352(1)).

87. The guidelines that were proposed for consultation purposes included a provision requiring the institution to keep the sensitivity of the ratio stable over time, i.e. within a prescribed range. The feedback on the consultation paper around this point has been negative, and the EBA acknowledges that such a requirement could make the regulatory framework overly prescriptive, in particular in light of the different business of the institutions in the Union. As a result, in the final version of the guidelines the institution is allowed to set its objective with respect to the risk management of the structural positions. That objective should also be based on quantitative criteria that are specific and detailed.

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<sup>11</sup> For example, the institution may decide to buy or sell FX forwards that are held in the banking book as they are taken with the purpose of hedging the ratio. The FX position stemming from the FX forwards would be part of the structural position that is eligible to be exempted.

88. When defining the objective, institutions are required at least to set a level of tolerance for the sensitivity of the ratio with respect to changes in the exchange rate and specify in detail the criteria and methodology for setting such a level of tolerance. Considering that the value taken by that sensitivity is driven by many factors (e.g. the level of the ratio, the shock applied to the current value of the exchange rate, the relation between own funds in the foreign currency and own funds requirements in that currency), the guidelines also specify that the criteria for setting the level of tolerance must encompass all components that may lead to changes in the value taken by the sensitivity and any specificity of the currency.

89. Several specific requirements have been included in the guidelines with respect to the information that the documentation describing the risk management framework should include. Again, this information should be as detailed as possible.

90. First, the risk management strategy should outline 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 structural. Those are also the boundaries that should be followed by the institution when categorising FX positions when entering into a new transaction bearing FX risk.

91. In addition, for the purpose of assessing whether the open structural position has been taken to hedge the ratio or not, the risk management strategy should outline how the institution plans to meet in a continuous manner the objective that the institution has set. In particular, it should cover at least the following aspects:

(a) It should clearly state which are the positions the institution intends to open/close in order to meet in a continuous manner the objective at the basis of the risk management framework, e.g. when seeking the permission at the consolidated level the institution is expected to at least indicate at which level (i.e. at the parent institution level or at the level of which subsidiary) it intends to open/close the positions to meet that objective.

(b) It should provide evidence that there are not impediments (of any nature) in opening/closing the positions identified in point (a). In particular:

- (i) The intention to close/open the positions identified in point (a) should not lead to any inconsistency with the overall risk management strategy of the institution. In addition, it should not lead to any inconsistency with risk management that the legal entities within the group may have in place, e.g. at the solo level.
- (ii) The intention to close/open the positions identified in point (a) should be consistent with the risk management strategies of the structural FX positions that legal entities (i.e. the parent bank/subsidiary) within the same group may have when applying the structural FX provision at a different level (i.e. on a solo/consolidated basis). In other words, closing/opening such positions, e.g. for the purpose of hedging the ratio at a consolidated level, must be compatible with the risk management strategy that the institution has for hedging the solo ratio.

92. The institution should also document and have available for supervisory review the type of positions (e.g. positions stemming from a specific subsidiary) and amounts (i.e. the net open position that is actually excluded) that are excluded from the FX charge in the market risk capital requirements.

93. Finally, as mentioned in paragraph 60, when the permission to offset positions within institutions in the group has not been granted (or it has been granted only for some of the institutions in the group) as per Article 325, the risk management framework should specifically describe how the institution manages positions that at the solo level are short for the purpose of hedging the ratio at the consolidated level. Competent authorities should indeed be able to assess whether the short position at the solo level has been taken with the sole purpose of hedging the ratio at the consolidated level.

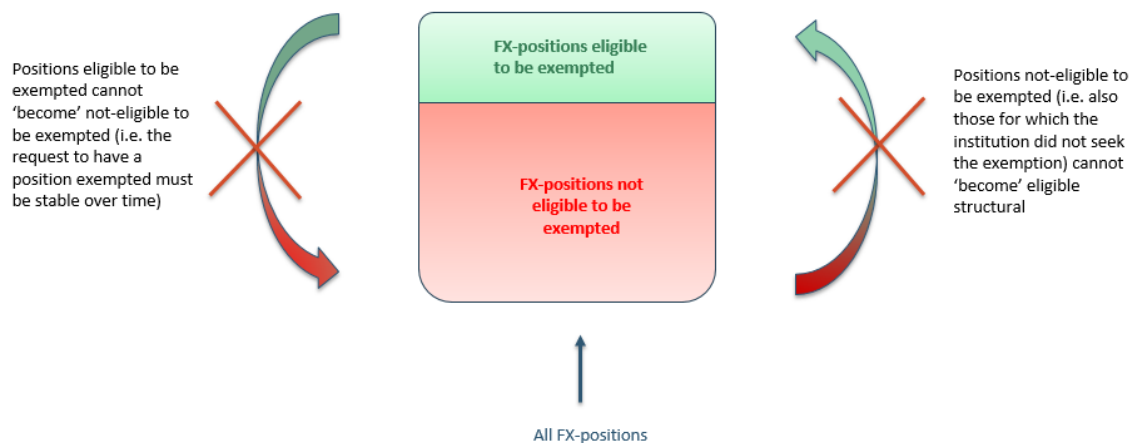
### 2.3.3 Minimum requirements for the exclusionary treatment of the hedge

94. The assessment made by the competent authority should lead to the identification of the positions that are suitable for the exemption. It is important to stress that this does not necessarily imply that such positions are actually exempted (i.e. excluded from the net open position); indeed, a portion of the open position generated might not be exempted due to the cap provided by the maximum open position that institutions can exempt – such a situation happens when the institution is actually over-hedging the ratio.

95. Once the exemption has been granted, institutions cannot change the boundaries distinguishing the positions that are suitable for the exemption from the positions that are not. In particular, if the institution did not seek the exemption for some positions, then, as previously mentioned, they must be treated (for all effects) as positions not suitable for the exemption. Accordingly, institutions cannot change the scope of the positions for which they seek the exemption.

96. This specification is deemed essential to avoid any regulatory arbitrage, in particular considering the broad interpretation in these guidelines of the meaning of ‘deliberately taken’. Figure 1 provides a graphical representation of this aspect. The guidelines include this specification by requiring the institution to outline the above-mentioned boundaries and by saying that they must be used when entering into a new FX position.

Figure 1



## 2.4 Treatment for items held at historical cost

97. The scope of the positions to be considered for the overall net FX position pursuant to Article 352(1) of the CRR comprises inter alia all asset and liability items (i.e. both in the trading book and in the non-trading book) in the respective currency (foreign or reporting currency) in question.

98. According to Article 92(4)(a) of the CRR, an institution must calculate the own funds requirements for market risk of all trading book positions and non-trading book positions subject to FX risk or commodity risk irrespective of their accounting treatment. Therefore, all trading book positions and non-trading book positions subject to the FX risk of an institution – with the possible exemption of structural positions in accordance with Article 352 – have to be included in the calculation of own funds requirements for market risk. This statement would also hold for what are known as non-monetary items, which are defined in the following paragraphs.

99. In accordance with accounting standard IAS 21, monetary items refer to assets/liabilities with a right to receive or an obligation to deliver a fixed or determinable amount of money. For all these items, regardless of whether they are reflected at historical cost or at fair value, the FX rate applied must be that of the reporting date<sup>12</sup>. Non-monetary items (i.e. items with the absence of a right to receive or an obligation to deliver a fixed or determinable amount of money) should be translated using the exchange rate at the date of the transaction, unless they are designated at fair value, either applying the fair-value option or if they are held with trading intent. For a typical institution,

<sup>12</sup> Here and in what follows, it is assumed that the functional currency (in accordance with IAS 21, i.e. the currency of the primary economic environment in which the entity operates, is identical to the (regulatory) reporting currency.

participations in subsidiaries in the individual balance sheet as well as real estate items would be such non-monetary items.

100. In general, non-monetary items that are booked at historical cost therefore do not change their balance sheet value with movements in the exchange rates. However, in the event of an indication of an impairment (due to a sharp move of the FX rate and/or due to other circumstances) the carrying amount of an asset is the lower of its carrying amount before considering possible impairment losses (with the FX rate at the date of the transaction) and its recoverable amount (with the FX rate at the reporting date). Thus, in certain instances a movement of the FX rate may also lead to FX-related losses with respect to non-monetary items that are booked at historical cost.

101. It is beyond the scope of these guidelines to clarify several aspects related to non-monetary items held at historical cost in the context of the FX risk, although the harmonisation of practices among jurisdictions on these aspects would be beneficial.

102. As previously mentioned, non-monetary items held at historical cost are within the scope of positions to include in the calculation of the open position. However, in the context of the structural FX treatment, they are not taken into consideration when comparing the value of the net open position stemming from positions that are eligible to be structural against the threshold set by the open position neutralising the sensitivity of the capital ratio with respect to changes in the exchange rate.

103. Accordingly, in the first instance, institutions should treat non-monetary items like all other items in this context. However, as mentioned above, they can be exempted from the calculation regardless of the threshold set by the maximum open position. In other words, for FX positions stemming from non-monetary items held at historical cost, the eligibility to be exempted coincides with fact of being structural<sup>13</sup>. In other words, items at historical cost do not have either a hedging effect on the ratio or an opposite effect to the hedging; indeed, for small FX changes they 'behave' like those items that are in the reporting currency. Accordingly, assessing the hedging effect in this context would not be meaningful. Example 7 in Annex II has been built to show the need for this specific treatment.

104. This ad hoc treatment is of particular relevance in the context of the structural FX provision applied at the solo level. Indeed, there is the presumption that non-monetary items at historical cost generating an FX risk would mainly be investments in subsidiaries denominated in a foreign currency (i.e. in general, the reporting currency of the subsidiary). Such investments are not part of the consolidated balance sheet, as the investments in the subsidiary (which are assets in the institution owning the subsidiary) net with the capital (i.e. liabilities side) of the subsidiary itself during the consolidation process. As a result, the above-mentioned treatment for non-monetary

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<sup>13</sup> This does not mean that an FX position stemming from non-monetary items at historical cost is automatically structural; instead, it implies that once the competent authority has assessed its structural nature such a position should automatically be considered eligible to be exempted.

items at historical cost is deemed to have a limited impact in the context of the structural FX provision at the consolidated level.

105. It should be noted that the EBA expects that institutions assess those items in their internal capital adequacy assessment process (ICAAP) and that they will be part of the supervisory review and evaluation process (SREP) if deemed necessary.

## 2.5 Calculation of the maximum net open position

106. One of the key features of these guidelines on structural FX is the definition of the maximum net open position that can be recognised as being taken for hedging the ratio to an institution by the competent authority.

107. The definition of the maximum open position is not trivial given the complex nature of the structural FX provision. In particular, the maximum net open position that can be exempted is defined as the amount of FX risk position that neutralises the sensitivity of the capital ratio to movements in the exchange rate. Indeed, above the maximum net position the institution loses the hedging effect when increasing the open position; accordingly, the position exceeding the maximum open position cannot be considered to be kept for hedging the ratio.

108. This section aims to define the methodology that the institution should apply to calculate the maximum risk position that can be recognised as suitable for the exemption.

109. As mentioned previously, paragraph 2 of Article 352 of the CRR specifies that any positions that an institution has taken in order to hedge its capital ratio against the adverse effect of the exchange rate may be excluded from the calculation of the net open position defined in paragraph 1 of the same article. In the context of these guidelines, hedging the capital ratio to FX changes is interpreted as reducing the capital ratio sensitivity to a change in the FX rate.

110. As the intention of hedging the ratio from FX changes by entering into any FX risk position precedes the fact of actually having such a position, the ratio that the institution wants to hedge is the one that the institution has without considering the own funds requirements (OFR) for that FX risk position. A similar reasoning can be followed for an open position that is maintained open for the purpose of hedging the ratio. Indeed, it could be argued that the institution keeps the position open for hedging the ratio, aware that such a position would be exempted from the open position.

111. Accordingly, when the sensitivity of the capital ratio to the FX rate is assessed for the purpose of calculating the maximum open position that can be recognised as structural, the capital ratio should be that without considering any own funds requirements for FX risk ( $FX - OFR$ ).

112. The decision to exclude the  $FX - OFR$  from the ratio for the purpose of calculating the maximum open position that can be recognised as structural:

- applies only to the currency for which the institution is calculating the maximum open position; i.e. the  $FX - OFR$  for all other currencies should be included in the ratio used for the calculation of the maximum open position;
- avoids the circular effect of calculating the open position neutralising the ratio, including also the  $FX - OFR$  of positions that will be excluded as part of the waiver.

113. Excluding the  $FX - OFR$  (just for the currency for which the exemption is sought) should not be burdensome for institutions. In particular:

- for institutions using the standardised approach for FX risk, this would simply require the institution to remove all positions in the currency for which the exemption is sought from the calculation of the net open position;
- for institutions using the internal model approach for FX risk, this would require institutions to run the value-at-risk model without considering changes in the relevant exchange rate.

114. In line with the reasoning above, these guidelines set out that the maximum net open position ( $MaxOP_{FC}$ ) that the institution may exclude (upon permission of the competent authority) when hedging the CET1 ratio is that calculated in accordance with the following formula:

$$MaxOP_{FC} = CET1 * \frac{RWA_{NoFX_{FC}} (1.01 * FX_{FC_0}) - RWA_{NoFX_{FC}} (FX_{FC_0})}{0.01 * FX_{FC_0} RWA_{NoFX_{FC}} (FX_{FC_0})} (*)$$

where  $MaxOP_{FC}$  is expressed in the foreign currency  $FC$  and:

$FX_{FC}$  is the spot exchange rate between the reporting currency and the foreign currency for which the institution is calculating the maximum open position that can be exempted (i.e. one unit of foreign currency corresponds to  $FX_{FC}$  units of the reporting currency);

$FX_{FC_0}$  is the value of  $FX_{FC}$  at the moment of the calculation of  $MaxOP$ ;

$RWA_{NoFX_{FC}}$  is the total risk exposure amount, as defined in Article 92 of the CRR (expressed in the reporting currency); it therefore includes both risk-weighted exposure amounts and own funds requirements arising from various types of risks, excluding the  $FX - OFR$  for the currency for which the institution is calculating the maximum open position that can be exempted;

$CET1$  is the Common equity Tier 1 of the institution (expressed in the reporting currency).

115. For the purpose of calculating the maximum open position for which the institution is hedging the T1 ratio (or the total capital ratio), the institution should:

- (i) calculate the amount using formula (\*), substituting the Common equity tier 1 in formula (\*) with the Tier 1 capital (resp. the Total capital).
- (ii) deduct from the amount obtained in (i) the delta equivalent of additional Tier 1 instruments (or the sum of the Additional Tier 1 (AT1) and Tier 2 (T2) instruments) issued in the structural currency.

116. Considering that:

- (i) the sensitivity to the exchange rate of the value of a non-monetary item denominated in the foreign currency held at historical cost is zero; and
- (ii) items in the foreign currency that have already been deducted from the CET1 (and accordingly from the T1 capital and the total capital) do not affect the sensitivity of the numerator of the ratio to FX rate<sup>14</sup>;

then, the *MaxOP* should represent an upper bound for risk positions that are suitable for the exemption, arising from items that are not within the scope of non-monetary items held at historical cost or within the scope of items deducted from the capital base. In other words, non-monetary items that are held at historical cost, and items that have been deducted from CET1 but included in the net open position, can be excluded from that net open position if they are of a structural nature.

117. As part of the consultation, some respondents identified another case of positions that do not impact the CET1, although included in the net open position in the foreign currency. The example was provided of some positions arising from minority interests that do not impact the CET1. The EBA agrees with the analysis provided by those respondents; hence, the guidelines have been amended, specifying that all positions leading to gains or losses that do not impact the CET1 are to be excluded from the net open position as long as they are structural (i.e. they are not subject to the cap imposed by the maximum open position). In other words, all those positions are to be treated as items that were deducted from the CET1 in the context of the structural FX framework.

118. It is important to highlight that the tax effect does not have to be considered when computing the maximum open position.

119. The institution should perform the calculation of the maximum open position at least monthly. The competent authority may (at any time) request the institution to compute the maximum open

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<sup>14</sup> It should be noted that in the FRTB standards it is clarified that positions stemming from items that have been deducted from the capital base must not be subject to own funds requirements for FX risk. However, Article 352(2) allows banks to exclude (subject to the permission of the competent authorities) positions that have been deducted from the capital base, meaning that there might be cases where such positions are actually included in the net open position.



position (e.g. if the exchange rate changes significantly) and to adjust the waived position accordingly.

120. As part of the feedback received from the consultation process, some respondents highlighted that it may be beneficial to introduce a derogation from the prescribed formula, allowing institutions to perform simplifications to that formula, as some of its components may not be material for the purpose of computing the value of the maximum open position. On the basis of such comments, the EBA decided to include in the final guidelines the possibility for institutions to perform simplifications to the formula provided in the guidelines as long as:

- (i) institutions are able to show the effect of such simplifications on the value taken by the maximum open position;
- (ii) the simplifications do not lead to an overestimation of the maximum open position.

In addition, when the institution makes such simplifications it has to also include a gap analysis in the documentation describing the risk management framework to show the effect of the simplifications on the value taken by the maximum open position.

121. Annex I presents the derivation of formula (\*).

## 2.6 Calculation of the FX-own funds requirements following the permission for the exemption

122. For the purpose of determining the own funds requirements associated with the FX risk once the permission has been granted, two different cases are distinguished:

- (i) where the size of the open position suitable for the exemption (i.e. the open position generated by the FX positions suitable for the exemption) is lower than the maximum open position;
- (ii) where the size of the open position suitable for the exemption (i.e. the open position generated by the FX positions eligible to be structural) is greater than the maximum open position.

123. Where the size of the open position suitable for the exemption is lower than the maximum open position (i.e. under-hedges), then the positions suitable for the exemption are excluded from the net open position. This means that all positions that are suitable for the exemption must not be taken into account when performing the calculation of the net open position in accordance with Article 352(1) following the structural FX permission.

124. Where the size of the open position eligible to be structural is greater than the maximum open position (i.e. over-hedges), then only the amount given by the maximum open position is exempted. This means that positions that are suitable for the exemption are to be removed from the calculation of the net open position to the extent that the structural net open position is equal to the maximum open position.

*Example:*

Consider the following ‘simplified balance sheet’ of an institution:

	Value in EUR		Value in EUR
Assets in EUR (BB <sup>15</sup> )	500	Liabilities in EUR (BB)	400
Assets in USD (BB)	300	Liabilities in USD (BB)	250
		CET1 in EUR	150

Suppose that all positions in the banking book are suitable for the exemption following the assessment of the competent authority and that the maximum net open position is 40. Then the new net open position should be computed as if USD 290 of assets and 250 USD of liabilities were removed (i.e.  $40 = 290 - 250$ ).

125. As specified in the previous section, when assessing the size of the net open position suitable for the exemption against the cap, the institution should not consider non-monetary items at historical cost, items that have been deducted from the CET1 and positions stemming from items that may lead to gains or losses that cannot be recognised in the CET1. The positions related to those items can indeed be excluded from the net open position as long as they are of a structural nature.

126. Institutions should inform the competent authority of the positions that are actually excluded from the net open position. In particular, in the case of over-hedges, since only a part of the positions can be actually waived, the institution should provide the competent authority with the criteria the institution uses for selecting the positions that are actually excluded.

127. In addition, institutions using the internal models for FX risk should specify the methodology that is used to exclude the waived FX positions from the computation of the own funds requirements and, in general, to transfer the concept of net open position in the context of the internal model approach. Examples of methodologies that the institution may use are presented below.

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<sup>15</sup> Banking book

*Example:*

*Institutions should be aware of the net present value of the portfolio of the positions in the banking book (BB) included in the internal model that are suitable for the exemption following the assessment of the competent authority. Suppose the net present value is 100. For banking book items, the net present value is a good approximation of the open position (associated with such items) calculated in accordance with Article 352(1). Accordingly, it could be assumed that 100 is also the open position calculated for the items that are suitable for the exemption in accordance with Article 352(1). Suppose the maximum open position calculated is 80.*

*The institution could include in its internal model a short position in cash in the foreign currency. The amount of such a short position should be equal to the maximum open position in the case of over-hedges, while for under-hedges it should be equal to the value of the net open position itself, which for positions stemming from items in the banking book can be approximated as the present value of the items themselves. Accordingly, in the specific case presented above, the institution would include a short position of 80 in its internal model<sup>16</sup>.*

*Alternatively, the institution may, for example, rescale its portfolio so that only 20 is capitalised. In this specific case, the institution should rescale its portfolio by one-fifth (i.e. 20/100) and consider the rescaled portfolio in its internal model. It should be noted that the 'rescaling' of the portfolio should not lead to a reduction of the commodity risk or non-delta risk (since only the delta risk component is possibly structural) that may stem from items included in the rescaled portfolio.*

128. Without prejudice to other requirements, in particular related to the use of internal models, although not part of the legal text of these guidelines, as these specifications would go beyond the scope of the guidelines, which deal with structural FX only, it should be noted that:

- (i) The EBA believes that institutions should not be requested to update the value of their banking book positions, e.g. on a daily basis, for the purpose of computing the own funds requirements for FX risk. Instead, for example, institutions should be required to consider the last available accounting value and perform only a daily revaluation of the FX component. This specification is relevant to over-hedges where institutions are required to capitalise some positions that were suitable for the exemption (and as such they are certainly banking book positions)<sup>17</sup>.
- (ii) During the SREP, competent authorities keep the ability to impose, if deemed necessary, Pillar 2 add-ons in case Pillar 1 requirements are assessed as not sufficiently adequate to

<sup>16</sup> In contrast, if the institution had a net open position of 70, then the institution would be under-hedging the ratio (indeed, the maximum open position, i.e. 80, is greater than the net structural open position). As a result, the short position in cash in the foreign currency to include in the internal model would be equal to 70.

<sup>17</sup> It should be noted that the EBA has a specific mandate to specify how institutions should calculate the own funds requirements for FX positions for the FRTB standardised and internal model approaches. Although such specifications will be legally applicable only in the context of the FRTB, the EBA intends as part of that mandate to clarify some aspects that may also be relevant to the current market risk framework.

reflect the actual risk; however, where the competent authority adopts Pillar 2 add-ons aimed at covering the structural FX risk, the EBA expects that the competent authority takes into consideration the Pillar 1 capital requirement and the frequency of the update of the value of the translation reserve when taking a decision on the amount of the Pillar 2 add-ons.

## 2.7 Approval of the competent authorities, ongoing monitoring of the waiver and changes in the risk management strategy of the structural FX positions

129. As usual, the approval of the competent authorities encompasses all specifications that the institution implements for meeting the requirements included in the previous sections (including those related to data that are used for computing the maximum open positions). Accordingly, the approval of the competent authority holds only under the condition that such specifications remain unchanged.

130. As soon as the institution plans to undertake any change to the specifications that are at the basis of an approval, it should inform the competent authority of the change. Accordingly, the competent authority should assess the change and, in proportion to the relevance/importance of the change, should/may take any supervisory measure it deems appropriate (e.g. withdrawal of the previously granted permission). For this purpose, as part of the reporting requirements set out below, the institution is also required to report whether it is planning to undertake any change.

131. It is important to stress that, even where the institution does not perform any change to the specifications at the basis of the approval, the competent authority has the power to take any supervisory measure it deems appropriate; for example, if the competent authority assesses that the institution is not actually implementing the strategy that was at the basis of the approval, it may decide to withdraw the permission that was previously granted, as the institution is not following the specifications that were made for receiving the waiver.

132. As mentioned, institutions are required to define an objective that is specific, detailed and supported by quantitative criteria. Where the institution does not meet this objective the competent authority should be informed in a timely manner and should be provided with the reason why this is the case. The competent authority should take any supervisory measure that is deemed appropriate. For example:

- The competent authority could withdraw the permission that was previously granted if the institution is not able to put in practice the strategy described in the application waiver (i.e. the strategy that was at the basis of the permission). Alternatively, the institution may propose a change to the strategy included in the application waiver that it is actually able to implement. Such a change should be treated as outlined in paragraph 130.

- The competent authority may require the institution to review the boundaries between the positions that are structural and those that are not, in order to reduce the amount of net open position suitable for the exemption. This could be the case, for example, where the competent authority assesses that there is a strong instability in some positions that were included in the scope of those that were suitable for the exemption and, accordingly, they may not be considered structural.

133. As set out in the previous section, the time horizon of the institution's strategy should be at least 6 months, meaning that the institution should not change e.g. the objective within a 6-month period from when the permission was granted. If after this period the institution wants to change the objective included in the strategy, for example due to a change in the business model, then it should be treated as a change to which the provisions in paragraph 130 apply.

134. After having received the permission in line with these guidelines, the more frequently the institution requires to apply changes to the terms at the basis of the permission, the more it could be argued that some positions for which the institution seeks the exemption are actually not stable (and, accordingly, of a structural nature). Accordingly, competent authorities are expected to consider also the terms at the basis of permissions that were granted in the past when assessing the terms of a change or a new permission.

135. The guidelines set out that institutions should inform the competent authority of the data and processes that are used for the purpose of defining and assessing the quantitative criteria that are the basis of the objective of the institution and used for computing the maximum open position.

136. In addition, institutions are required to regularly provide an overview of the structural FX provision, which is to contain a template for the structural FX provision. This reporting is to ensure that the essential information necessary to monitor the development of structural FX positions is available in one template, providing one source of information for the competent authority. The template shall include at least the following information separately for each currency – the respective figures shall be calculated by the end of the month and reported quarterly:

- the net open FX position in the currency previous to any exemption;
- the amount of positions that are not structural;
- the amount of positions that are suitable for the exemption and the amount of those that are not;
- the maximum open position calculated in accordance with the formula provided in these guidelines;
- the open position that is excluded from the net open FX position following the permission of the competent authority;

- the sensitivity of the ratio calculated in accordance with a prescribed formula (see the next paragraph) and the sensitivity calculated by the institution using internal methodologies;
- a qualitative assessment stating the reasons for changes in the amount of the structural net open position and the value taken by the sensitivity;
- the percentage of total credit risk RWAs in the foreign currency to the total RWAs of the institution.

137. Along with the sensitivity of the ratio calculated in accordance with internal methodologies, institutions should calculate the sensitivity of the ratio to FX movements as follows:

$$\text{Sensitivity} = \frac{S_{OP} - \text{MaxOP}}{RWA_{NoFXFC}}$$

where:

$S_{OP}$  is the size of the net open position stemming from positions that are suitable for the exemption expressed in the foreign currency (excluding positions corresponding to items that have been deducted from the institution's own funds, items that are held at historical cost and items that do not impact on the CET1 capital of the institution);

$\text{MaxOP}$  is the maximum open position calculated in accordance with Section 2.5 (and expressed in the foreign currency);

$RWA_{NoFXFC}$  is the total risk exposure amount as defined in Article 92 of the CRR; it includes both risk-weighted exposure amounts and own funds requirements arising from various types of risks, excluding the  $FX - OFR$  for the currency for which the institution is applying the structural FX provision.

138. The derivation of the formula to compute the sensitivity is provided in Annex I, along with the derivation of the formula that the institution should use for calculating the maximum open position that can be exempted.

139. The template, including all the above-mentioned information, is to be submitted to competent authorities on a quarterly basis. Because this template is not included in the XBRL taxonomy, the technical submission is to be agreed with the competent authority.

140. It should be noted that the EBA decided not to include the above-mentioned reporting requirements in the current Common Reporting (COREP) templates, considering that institutions will switch in a few years to the new FRTB requirements for capital purposes too and, accordingly, they will be required to fill in a new set of templates. However, the EBA intends to include such requirements in COREP in the future to have a more structured tool for reporting relevant information on structural FX.

141. Finally, the EBA thinks that essential information on structural FX provisions should be regularly reported to senior management and management bodies within the institution.

### **Transitional arrangement**

These guidelines specify that competent authorities should review, update or revoke permissions already granted at the date of application of these guidelines, regardless of the duration of the permission that may have been granted. The review of past waivers should be done through close cooperation with the supervised entities, in close supervisory dialogue. Finally, it should be noted that the date of application of these guidelines is related only to how the structural FX provision should be applied, i.e. it does not allow a postponement of requirements that are set out in the level 1 text.

## 3. Guidelines

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## Guidelines

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

# 1. Compliance and reporting obligations

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## Status of these guidelines

1. This document contains guidelines issued pursuant to Article 16 of Regulation (EU) No 1093/2010<sup>18</sup>. 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](mailto: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).

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<sup>18</sup> 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

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### 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

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### 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

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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

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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

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### 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

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### 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 exchange 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

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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:

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

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:

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

where:

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

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

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

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;

$RWA_{NoFX_{FC}}(\cdot)$  = 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

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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:

$$(i) \text{ sensitivity}_1 = \frac{S_{OP} - MaxOP_{FC}}{RWA_{NoFXFC}}$$

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;

$RWA_{NoFXFC}$  = 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.

## 4. Accompanying documents

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### 4.1 Draft cost–benefit analysis/impact assessment

The EBA has developed these own-initiative draft guidelines on the practical implementation of ‘structural FX’ provision contemplated in Article 352(2) of the CRR.

Article 16(2) of Regulation (EU) No 1093/2010 (EBA Regulation) provides that any guidelines and recommendations developed by the EBA should be accompanied by an analysis of ‘the potential related costs and benefits’. This analysis should provide an overview of the findings regarding the problem to be dealt with, the solutions proposed and the potential impact of these options.

This section presents the cost–benefit analysis of the main policy options included in the draft guidelines. Given that there are no specific reporting requirements related to structural FX in the current supervisory reporting framework (COREP/FINREP), the analysis is high level and qualitative in nature.

#### A. Problem identification

Article 352(2) of the CRR allows competent authorities to permit, on an ad hoc basis, the exclusion of FX risk positions from the calculation of net open currency positions where an institution has deliberately taken these positions to hedge against adverse effects of the exchange rates on its capital ratios. Such positions should be of a non-trading or structural nature.

Over the last few years institutions have become increasingly interested in the application of the structural FX provision. However, this provision has been subject to several interpretations by both supervisory authorities and institutions, leading to differences in its application across the EU. In addition, there has been a lack of clarity around what constitutes a structural position for the purposes of Article 352(2).

#### B. Policy objectives

The objective of these draft guidelines is to provide for a harmonised approach to the practical implementation of the structural FX provision contemplated in Article 352(2) of the CRR. In this way, the guidelines aim to ensure a level playing field and promote convergence of supervisory practices across the EU regarding the exclusion of structural FX positions from capital requirements.

### C. Baseline scenario

The baseline scenario in terms of the regulatory environment assumes the full implementation of the CRR and CRR2. It is important to note that, even if these guidelines consider the provisions under the current CRR, the same provisions have been kept under CRR2. Accordingly, these guidelines have been developed considering changes to the market risk framework introduced in the CRR2, which builds on the new FRTB standards published by the Basel Committee on Banking Supervision (BCBS in January 2019, and taking into account the structural FX treatment envisaged in the standards.

### D. Options considered, cost–benefit analysis and preferred options

#### Materiality (or relevance) of a currency in the context of the structural FX provision

Article 352(2) refers to the adverse effect of the exchange rate as the exchange rate between the reporting currency and any other currency. Accordingly, an institution may request the permission for excluding from the relevant net open positions FX risk positions in more than one currency. The guidelines clarify that the permission should be sought (and potentially granted) for currencies that are material with respect to the business of the institution. In particular, it could be argued that positions in a currency that is not material for the institution should not be considered to be deliberately taken for hedging the ratio from the correspondent exchange rate; indeed, movements in such exchange rate would negligibly affect the ratio.

The following options have been considered to determine whether a currency can be presumed to be material or not with respect to the business of the institution. It should be noted that these options refer only to the currencies that can *automatically* be presumed to be material (i.e. without any further justification); however, this does not rule out more currencies being considered material where the institution is able to justify this.

**Option 1a: determine materiality (or relevance) based on an absolute threshold.**

**Option 1b: determine materiality (or relevance) based on a relative threshold.**

Under Option 1a, a fixed number ( $n$ ) of currencies will be presumed to be the most material currencies. This option provides for a simple rule to identify material currencies, which is expected to cover all relevant currencies in most cases. However, there might be cases in which even the top  $n$  currencies are not relevant or cases in which positions in currencies that are not among the top  $n$  are actually material for the institution (e.g. where the institution performs its business in several countries with different currencies).

Under Option 1b, a relative threshold was considered based on the following measures:



- measure A: the percentage of the open position in the foreign currency (without considering any waiver) with respect to the 'open position' in the reporting currency;
- measure B: the percentage of the open position in the foreign currency (without considering any waiver) with respect to the total own funds of the institution;
- measure C: the percentage of total credit risk RWAs in the foreign currency with respect to the total RWAs of the institution;

These measures allow a more risk-sensitive assessment of the materiality of a currency, as they take into account the actual business of the institution. While this option can provide for a more risk-sensitive measure of materiality, it may introduce an additional burden for institutions, as they will need to calculate the above measures before seeking a permission.

The EBA put forward for consultation Option 1a, presuming that the top three currencies are material. However, acknowledging that such an absolute threshold may not capture the actual relevance of a currency, the EBA sought feedback on alternative measures that could be included in the final draft guidelines for this purpose. Most respondents were opposed to the limitation of the structural FX waiver to the three most material currencies. One respondent suggested raising the number of material currencies to five.

The EBA acknowledges that the limit of three material currencies put forward in the consultation paper may be too strict with respect to the business of some institutions; therefore, the final draft guidelines were amended in order to allow for five material currencies. In addition, the EBA highlights that the draft guidelines do not set any limit to the number of currencies for which an institution may apply for the waiver, as long as it is able to demonstrate that they are material for its business. In that sense, the simplicity of Option 1a over Option 1b was favoured, while the measures discussed under Option 1b could be used – among others – by the institution to demonstrate the materiality of a currency that is not among the top five. In addition, measure C is included in the reporting requirements set out as part of the ongoing monitoring of a permission.

Option 1a has been retained.

### Assessment of the intention to hedge the ratio against the effects of exchange rate movements

Article 352 specifies that, when the institution applies for the structural FX provision, the institution is required to justify that the position for which the exemption is sought has been deliberately taken (or maintained) to hedge the ratio against the effects of exchange rate movements.

The EBA has considered the following options for how this objective can be assessed:

**Option 2a: require institutions to keep the sensitivity stable over time (i.e. within a prescribed range).**

**Option 2b: use a principle-based approach.**

Under Option 2a, the EBA would require institutions to keep the level of the sensitivity of the capital ratio to movements in the relevant exchange rate within a prescribed range. The sensitivity and range considered are defined as follows:

$$Sensitivity = \frac{S_{OP} - MaxOP}{RWA_{NoFX_{FC}}}$$

$$Range = \left[ Target - \frac{0.05 \cdot S_{OP}_{inception}}{RWA_{NoFX_{FC}_{inception}}}; Target + \frac{0.05 \cdot S_{OP}_{inception}}{RWA_{NoFX_{FC}_{inception}}} \right]$$

where:

$S_{OP}$  is the size of the net open position stemming from positions that are suitable for the exemption expressed in the foreign currency (excluding positions corresponding to items that have been deducted from the institution's own funds and items that are held at historical cost);

$MaxOP$  is the maximum open position, calculated in accordance with Section 2.5 (and expressed in the foreign currency);

$RWA_{NoFX_{FC}}$  is the total risk exposure amount, as defined in Article 92 of the CRR; it includes both risk-weighted exposure amounts and own funds requirements arising from various types of risks, excluding the  $FX - OFR$  for the currency for which the institution is applying the structural FX provision;

$Target$  is the sensitivity targeted by the institution;

$Inception$  is the date of the request of the permission to the competent authority.

Under Option 2b, a principle-based approach to how to assess the intention to hedge the ratio is considered. In particular, no specific quantitative measures are prescribed in the guidelines; instead, the institution needs to set out the objective to hedge the ratio from movements in the exchange rate over time in its risk management framework and define and assess the objective by means of detailed and specific quantitative measures and qualitative criteria. In addition, the institution would be required to at least specify a level of tolerance for the sensitivity of the ratio with respect to changes in the exchange rate and specify in detail the criteria and methodology for setting that 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. In a sense, these principles follow a similar assessment philosophy to Option 2a, but without prescribing an explicit formula for the sensitivity and range.

Option 2a provides for a more harmonised approach to how to assess the intention to hedge a ratio. However, it may be overly prescriptive and in some cases inconsistent with the actual risk management practices of the institutions. This may force institutions to adapt their management practices simply for the purposes of respecting the range, although this might not necessarily lead to better management of FX risk. Moreover, a tight range may make it impossible to perform other hedging activities than the ones stipulated by the guidelines, e.g. in cases where an institution performs hedging activities based on a target ratio (considering, for example, upcoming deals, sales or dividend payments, or based on additional tax considerations) instead of the actual capital ratio. Finally, setting a lower bound on the sensitivity range may be counterintuitive, as the lower the sensitivity the more effective the hedging of the ratio is. Finally, a fixed boundary may not be appropriate for different currencies, given that their volatility is not the same; for currencies with higher volatility, it would be more difficult to keep the sensitivity within the same fixed prescribed range.

Option 2b enables these problems to be overcome by allowing the institution to set out its own objective and the quantitative measures and quantitative criteria used to assess it. In particular, the principles prescribe that the institution should at least specify a level of tolerance for the sensitivity of the ratio with respect to changes in the exchange rate, which serves a similar purpose to the range under Option 1a, but without explicitly prescribing a formula.

The EBA put forward for consultation Option 2a. Respondents to the consultation believed that the framework is overly prescriptive and complex and should be replaced by high-level principles that will rely on institutions' policies for the treatment of FX risk, subject to approval by the competent authority. In addition, some respondents argued that the sensitivity formula should consider the overall net open position in a foreign currency, i.e. both positions that are suitable for the exemption and positions that are not. In this way, the formula will capture the real sensitivity impacting the capital ratio. This may be particularly relevant where the positions that are not suitable for the exemption are material and the two sensitivity measures would diverge<sup>19</sup>. In this case, Option 1a may expose institutions to potential misalignments in the management of both metrics at the same time. Finally, most respondents disagreed with the specified range for various reasons. The main reasons were as follows: (a) the range was considered too restrictive, with some respondents proposing higher values than 0.05; (b) the range should be decided on a case-by-case basis and/or included in the risk management framework of the institution and may depend on the levels of FX rate volatilities, cost of hedging and sufficient market liquidity to execute hedges; (c) it seems counterproductive to ask an institution to stabilise the level of sensitivity of the ratio at a certain level if it is possible to lower and thus improve it – this is particularly relevant if the options are used to hedge the ratio; and (d) it does not take RWAs/ratio development (new deals, sales, dividends, etc.) into account and thus may lead to unnecessary trading activities.

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<sup>19</sup> On the other hand, if the positions that are not suitable for the exemption are immaterial the two sensitivity measures are expected to be similar.

The EBA acknowledges that there is some room for simplification regarding the sensitivity framework put forward in the consultation paper and has therefore amended the final draft guidelines to allow for a principle-based approach when assessing the intention to hedge the ratio. Nevertheless, in order to allow national competent authorities to effectively monitor the permission, the sensitivity of the ratio, as defined under Option 2a, along with several other measures, has been included among the reporting requirements set out as part of the ongoing monitoring of a permission.

Option 2b has been retained.

## 4.2 Feedback on the public consultation

The EBA undertook a public consultation on the guidelines contained in this paper. The consultation period lasted for 3 months and ended on 17 January 2020.

Twenty-one responses were received, of which only six were non-confidential and were published on the EBA website.

This section presents a summary of the key points and other comments arising from the consultation, the analysis and discussion triggered by these comments and the actions taken to address them if deemed necessary.

In a number of cases, some industry bodies made similar comments or the same body repeated its comments in response to different questions. Such comments and the EBA's analysis of them are included in the section of this paper where the EBA considers them most appropriate. Changes to the guidelines have been incorporated as a result of the responses received during the public consultation.

### 4.2.1 Summary of key issues and the EBA's response

In the feedback table that follows, the EBA has summarised the comments received and explains which responses have and have not led to changes, and the reasons for this.

As part of the general comments several respondents claimed that only positions leading to gains or losses that are accounted for in the P&L should be capitalised. The EBA would like to note that Article 352(1) does not link in any way the accounting treatment with a possible exclusion from the FX capital charge. Positions of type A are accordingly attracting own funds requirements for FX risk. Not capitalising them would make an institution non-compliant with the CRR text. As a result, no changes have been made to reflect this comment.

With respect to the scope of the applications of the waiver, all respondents were against any potential restriction requiring institutions to hedge the CET1 ratio. Some respondents were in favour of requiring all institutions to use the standardised approach for performing the calculations included in the guidelines. The EBA decided not to amend the guidelines in this respect, i.e.

institutions will be free to pick any of the three capital ratios and to apply for the waiver using internal model figures.

In general, respondents have expressed concerns about the threshold imposed by the number of currencies for which the presumption of materiality is recognised. The EBA wants to stress that the limit does not lead to any sort of automaticity, i.e. institutions may apply for other currencies on top of those fulfilling the threshold criteria as long as they provide a justification of the relevance of the currencies for their business. In addition, the EBA raised the number of currencies for which the presumption of materiality is recognised from three to five.

Few respondents proposed also including in the scope of the waiver positions booked in the trading book. The EBA decided not to amend the guidelines for the reasons that have been outlined in the background section of this paper.

All respondents found the requirement to keep the sensitivity stable over time within a certain range too rigid and overly prescriptive. Some respondents proposed dropping that requirement from the guidelines, while others proposed significantly increasing the size of the range compared with that in the consultation paper. It was also proposed to have a reporting phase for the purpose of calibrating the size of the range. Considering the diversity of practices among institutions in the Union for the purpose of hedging the ratio, the EBA decided to remove from the guidelines the requirement to keep the sensitivity stable over time. However, the EBA still requires institutions to specify a level of tolerance for the sensitivity of the ratio to changes in the exchange rate; institutions are also required to specify the methodology that is used for setting the level of tolerance. In addition, institutions are still required to report the sensitivity calculations as part of the reporting requirements that have been set out for the purpose of ongoing monitoring.

Some respondents deemed the formula for calculating the maximum open position appropriate, while others proposed letting institutions calculate this amount. No changes have been made in this respect. The EBA would like to stress that the requirement that the maximum open position that can be exempted is the one offsetting the sensitivity of the ratio to changes in the exchange rate is also included in the FRTB standards.

Some respondents, while agreeing on the appropriateness of the formulas for calculating the maximum open position, proposed allowing institutions to perform simplifications to the formulas. For example, respondents claimed that there could be non-material components of RWAs that are not worth considering when performing the calculations. The EBA decided to introduce this possibility, as long as the simplifications made by the institution do not lead to an overestimation of the maximum open position.

## Summary of responses to the consultation and the EBA's analysis

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
<b>General comments</b>			
Eligibility of short and/or trading book positions for the structural FX waiver.	Some respondents argue that banks usually manage the FX risk stemming from investments in subsidiaries in a separate entity (e.g. parent company); thus, net short positions at the individual level should be eligible for the waiver as long as they hedge the FX risk stemming from long positions that are eligible for the waiver in different entities of the group – this should also include hedges that are held in the trading book.	The EBA is of the view that Article 352(2) of the CRR prevents positions that are not 'of a non-trading or structural nature' from being eligible for the waiver under the guidelines. The EBA also interprets this passage of the CRR as a specification (i.e. 'of a non-trading, that is, of structural nature'); thus, trading book positions are not eligible for the waiver. Furthermore, the CRR explicitly states that the position must be 'deliberately taken in order to hedge against the adverse effect of the exchange rate on its ratios', preventing net short positions from being eligible for the waiver when this is sought at an individual level, since those positions do not hedge the ratio.	No amendments.
Capitalisation in Pillar 1 of risks that do not affect the accounting P&L.	Some respondents deem that risks that do not have an impact on the accounting P&L should not be capitalised under Pillar 1. Thus, according to the respondents, most positions of type A should not be capitalised and the guidelines should apply only for positions of type B. One respondent proposes waiving from the cap of the maximum open position FX positions that do not affect the accounting P&L.	The CRR does not limit the scope of Pillar 1 capital requirements only to risks that materialise in the accounting P&L. Similarly, Article 352(2) of the CRR does not provide for a preferential treatment (e.g. looser requirements with regard to the hedge effectiveness of the ratio) for instruments that do not affect the accounting P&L.	No amendments.
Framework overly prescriptive and complex.	Some respondents believe that the framework designed in the guidelines is overly prescriptive and complex and should be replaced by high-level	The EBA is of the view that it is in the primary interest of the industry to be able to make reference to an accurate regulatory framework. This also benefits the	Amendments to Section 7.

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	<p>principles that will rely on banks' policies for the treatment of FX risk, which in turn must be approved by the competent authority. They also complain that the obligation to undergo a new application process for minor changes in the management of FX risk is disproportionate and may result in multiple application processes.</p>	<p>level playing field. Nevertheless, the EBA acknowledges that there is room for further simplification; therefore, for example, the guidelines no longer require institutions to keep the sensitivity of the ratio with respect to changes in the exchange rate within a certain range over time.</p>	
<p>Number of currencies for which the structural FX waiver can be granted.</p>	<p>Most respondents oppose the limitation of the structural FX waiver to the three most material currencies. Some respondents suggest raising the number of material currencies from three to five.</p>	<p>The EBA acknowledges that the limit of three material currencies may be too low with respect to the business of the institutions; thus, the guidelines are amended in order to allow for five material currencies. The EBA highlights, however, that the guidelines do not set any limit to the number of currencies for which an institution may apply for the waiver, as long as it is able to demonstrate that they are relevant to the business model of the institution (e.g. on the basis of the cross-border nature of the activities performed by the institution).</p>	<p>Guidelines are amended as follows:  '... currencies that should be considered relevant to the business of the institution should be the <del>three</del> 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'.</p>
<p>Date of application.</p>	<p>Several respondents deem that the proposed date of application of the guidelines is challenging and should be postponed for at least 2 years. It is also suggested that the application date be aligned with the FRTB dates.</p>	<p>The EBA acknowledges that the proposed date of application may be challenging for institutions and supervisors; therefore, the guidelines are postponed for 1 year.</p>	<p>Amendment to the application date.</p>

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
Scope of positions recognised as structural in the guidelines.	Some respondents suggest extending the scope of positions recognised as structural in the guidelines to branches and to investments in associates and in joint ventures. It is also suggested to extend the scope to all investments that carry sufficient hidden reserves to compensate for FX risk.	<p>The guidelines recognised the presumption of the structural nature for positions of type A since they do not attract any capital requirements for FX risk on an individual basis, i.e. the own funds requirements for FX risk on a consolidated basis stem from the translation process. Positions stemming from branches do not meet such criteria.</p> <p>The fact that positions stemming from branches are positions of type B does not exclude institutions also being able to request the permission for those positions. However, in that case, the presumption of the structural nature is not recognised in the guidelines and should be supported by an adequate justification.</p>	No amendments.
Impact on business models of the institutions.	Some respondents deem that the guidelines will impact the business models of the banks, causing a reduction of the capital of the subsidiaries and the engagement in fully financed business activities in local currencies.	The EBA believes that this comment is outside the scope of the guidelines.	No amendments.
Interaction with capital buffers.	Some respondents believe that the systemic risk buffer and the O-SII buffer overlap with the capital requirements for non-exempted FX positions, since they are charged for the cross-border business component of the banks.	The EBA considers that this topic is outside the scope of the guidelines.	No amendments.
Calculation of the maximum open position.	Some respondents deem it appropriate to specify that the calculation of the maximum open position and the sensitivities must be performed using the standardised approach. One respondent considers	The EBA does not deem it beneficial to force all institutions to use the standardised approach for computing the maximum open position. In particular, the maximum open position should be the one that	No amendments.



Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	it beneficial to clarify the methodology used to calculate the open net FX position at a consolidated level.	<p>offsets the sensitivity of the actual ratio to movements in the exchange rate; as such, it has to be computed using all figures that are used for obtaining the actual ratio (i.e. with internal model figures for intern model institutions).</p> <p>On the calculation of the consolidated maximum open position and the consolidated net open FX position, the EBA deems that these issues deal with the level 1 text and thus are outside the scope of the guidelines. However, the EBA plans to address this issue either via a Q&amp;A or via any other tool that is fit for the purpose.</p>	
Inclusion of the items held at historical cost in the net open FX position.	Some respondents stated that items held at historical cost are already excluded from the calculation of the net open FX position according to Article 352(1) of the CRR; thus, the guidelines are redundant.	The view of the EBA is that the specification that items held at historical cost are not subject to the cap given by the maximum open FX position is necessary in order to avoid possible different interpretations. The EBA will, however, provide clarity around the treatment of these items with respect to their inclusion in the scope of items attracting an FX charge in the regulatory technical standards (RTS) on FX and Commodity risk in the non-trading book.	No amendments.
Accounting issues.	One respondent believes that the accounting treatment of FX positions has not been thoroughly addressed in the guidelines. Furthermore, it is claimed that the guidelines go against the Memorandum of Understanding for mutual cooperation between the BCBS and the International Financial Reporting Standards (IFRS) Foundation. Finally, it is suggested that the examples in the background section of the	The EBA is not of the view that the guidelines go against the Memorandum of Understanding for mutual cooperation between the BCBS and the IFRS Foundation. Furthermore, the EBA clarifies that the examples provided in Annex II are developed from a prudential perspective and do not imply any specific accounting treatment.	No amendments.

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	guidelines may not hold true for institutions that apply Directive 86/635/EEC.		
Interaction between the calculation of the maximum open position and FX RWAs.	One respondent notes that the formula to calculate the maximum open position, based on the RWAs, is penalising for institutions that hold less risky FX assets since it allows a smaller maximum open position to be exempted.	The point made by the respondent is acknowledged by the EBA. However, the fact that the maximum open position is greater for institutions with riskier FX assets is within the nature of the provision included, even in the FRTB standards limiting the exemption to the position perfectly hedging the ratio.  In addition, the positions in excess with respect to the maximum open position cannot be considered to be kept for hedging the ratio (since actually they do not hedge the ratio) and as such they have to be capitalised.	No amendments.
<b>Responses to questions in Consultation Paper EBA/CP/2019/11</b>			
<b>Question 1.</b> Would you consider it beneficial to limit the structural FX provision to hedge the CET1 ratio aiming at creating a level playing field in the EU? Please provide a rationale.	All respondents are against limiting the structural FX provision to the CET1 ratio. It was mentioned that banks should also be allowed to use the leverage ratio or even TLAC, MREL and other internally defined ratios.	Article 352 refers to hedging against the adverse effect on the <i>ratios</i> in accordance with Article 92(1) of the CRR, which lists the three prudential own funds ratios (CET1, T1 and total capital) and establishes the minimum levels required. It is less specific about which of the ratios should be the hedge target. Indeed, the level 1 text does not constrain the application of the hedge to any of the aforementioned ratios.  In addition (as also set out in the Basel standards), the structural FX exemption applies in the context of the capital ratios.	No amendments.

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
		The EBA decided not to amend the guidelines around this aspect.	
<b>Question 2.</b> Which of the three ratios is your institution hedging?	No non-confidential responses were received to this question.	No non-confidential responses were received to this question. The comments received have been processed and analysed but cannot be reproduced here since they were all confidential.	No amendments.
<b>Question 3.</b> For how many and for which currencies do you currently have the permission to exclude some positions from the corresponding net open position? For how many and for which currencies do you plan to request the permission following the adoption of these guidelines?	No respondents favoured the eligibility criterion for the three most material currencies for the institution. An increase in the number of eligible currencies up to the five most material currencies of an institution was suggested. It was also suggested that an assessment of the currency materiality should be based on the bank's business model (i.e. currencies in which there is a significant amount of FX business).	The EBA acknowledges that institutions may apply the structural FX provision for more than three currencies.  As noted above, the EBA acknowledges that the limit of three material currencies may be too low with respect to the business of the institutions; thus, the guidelines are amended in order to allow for five material currencies. The EBA highlights, however, that the guidelines do not set any limit to the number of currencies for which an institution may apply for the waiver, as long as it is able to demonstrate that they are relevant to the business model of the institution.	Number of relevant currencies automatically recognised as such amended from three to five.
<b>Question 4.</b> Could you please provide the list of the 10 most material currencies if the materiality of a currency were assessed in accordance with measure A and measure B? Please provide also the value taken by measure A and measure B for those currencies. Measure A: percentage of the	No non-confidential responses including the list of the 10 most material currencies were provided.  One respondent suggested two alternative measures: <ul style="list-style-type: none"><li>the percentage of foreign currency-denominated subsidiary equity to consolidated equity in the reporting currency;</li></ul>	Considering that institutions are also allowed to request the permission also for other currencies on top of the top five currencies, the EBA prefers to keep the simple approach included in the proposed guidelines for identifying the most material currencies.  The EBA acknowledges some of the alternative measures proposed. In particular, the share of total credit RWAs held in the foreign currency to the total	No amendments to the measure for identifying the five relevant currencies.

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
<p>open position in the foreign currency (without considering any waiver) with respect to the open position in the reporting currency. Measure B: percentage of the open position in the foreign currency (without considering any waiver) with respect to the total own funds of the institution.</p>	<ul style="list-style-type: none"> <li>the percentage of total credit RWAs in the foreign currency to the total RWAs of the institution.</li> </ul> <p>One respondent alternatively suggested a categorisation of currencies (passive, active or not used for structural FX purposes) as part of the risk management framework.</p> <p>Others did not provide any figures and suggested relaxing the materiality thresholds, stating that the current approach is overriding the level 1 text.</p>	<p>RWAs of the institution might prove to be a more meaningful measure. Accordingly, the EBA included this measure as part of the reporting requirements in Section 9, and it could be used by institutions to, for example, prove the relevance of a currency for the business of the institution.</p>	
<p><b>Question 5.</b> Do you deem the provision included in paragraph 25 clear or do you think it could lead to a different interpretation than the one outlined in the text above included in the box? Please elaborate.</p>	<p>Some respondents responded that the provision is clear.</p> <p>One respondent mentioned that ‘Article 325 CRR allows institutions (on the consolidating level) <i>“to offset positions in another institution or undertaking”</i> within the same group whilst Article 352(2) CRR gives details about how to calculate the overall net foreign exchange position for one specific institution without set-off by and between two different institutions playing any role. Participations in subsidiaries of such institution can only and are only booked on the balance sheet of such institution and in lieu of any other party a setoff is not even possible to apply. For such positions it would not make any sense to apply different scenarios as the CP is envisaging.’</p> <p>Some respondents seem to have replied to the question referring to paragraph 25 of the</p>	<p>The EBA acknowledges that a long position at the level of the institution hedges the ratio regardless of whether the permission in Article 325 has been granted or not. Accordingly, the EBA decided to amend the provisions in paragraph 25. However, some requirements have been identified and explained in detail in the background section to ensure a prudential framework where the institution does not have the permission referred to in Article 325.</p>	<p>Amendment to paragraph 25.</p>

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	background section and not paragraph 25 of the legal text.		
<p><b>Question 6.</b> Are the structural positions for which you plan to ask the permission mainly positions of type A or positions of type B? Could you please provide a rough estimation of the percentage of positions of type A on the total foreign-exchange position that you will potentially include in the request to the competent authority?</p>	<p>No non-confidential responses were given providing the estimate required in the question.</p> <p>Although not directly replying to the question, some respondents mentioned that no capital charge should be associated with investments in subsidiaries and capital allocations to branches as they do not trigger any P&amp;L and accordingly a waiver is not necessary. Only type B positions would be eligible for exemptions as type A transactions and the positions stemming from them do not affect the net open position.</p> <p>It was argued that in the CRR and in the Basel framework there is no example of a Pillar 1 capital charge that would not relate to an impact on P&amp;L.</p>	<p>Own funds requirements for market risk are not driven by the accounting treatment; instead, all items that are in the trading book and non-trading book are subject to own funds requirements for FX risk, as set out in Article 92 of the CRR.</p> <p>Positions of type A are accordingly within the scope of the own funds requirements for FX risk, and are then possibly waived via the structural FX waiver.</p>	No amendments.
<p><b>Question 7.</b> Could you please provide the percentage of the net open position that you plan to request to exclude with respect to the net open position that your institution has without any waiver?</p>	<p>No non-confidential responses were given providing the estimate required in the question.</p>	<p>No non-confidential responses were given providing the estimate required in the question. The comments received have been processed and analysed but cannot be reproduced here since they were all confidential.</p>	No amendments.
<p><b>Question 8.</b> Do you agree with the exclusion of positions that are not eligible to be structural from the sensitivity that is used for assessing the intention of</p>	<p>Some respondents stated that the sensitivity should be calculated on the whole position and should not be limited to positions that are eligible to be structural.</p>	<p>The EBA acknowledges that for some respondents it may be better to exclude those positions when computing the sensitivity, while for others this way of computing the sensitivity may not be in line with the sensitivity that is computed for internal purposes.</p>	Amendments to Section 7 and to Section 9.

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
<p>the institution to hedge the ratio, or would you prefer to have those positions included although they cannot be exempted? Please elaborate.</p>	<p>By contrast, other respondents agreed with the exclusion of positions that are not eligible to be structural from the sensitivity that is used for assessing the intention of the institution to hedge the ratio.</p>	<p>In general, the EBA decided to remove the requirements for institutions to keep the sensitivity stable over time and accordingly decided to amend Section 7 of the proposed guidelines. However:</p> <p>(i) Institutions are required to provide quantitative criteria for defining the objective at the basis of their strategy. The EBA expects the sensitivity of the ratio with respect to changes in the exchange rate to be at the basis of the institutions' strategies.</p> <p>(ii) Institutions are required to report for monitoring purposes the sensitivity as prescribed in the proposed guidelines, and the sensitivity that they use for internal purposes.</p>	
<p><b>Question 9.</b> Are there currently FX risk positions that you kept open in the trading book for the purpose of hedging the ratio? Why did you not include such positions as part of the banking book since the main purpose of those positions is to hedge the ratio?</p>	<p>Two respondents agreed with the limitation of the structural FX provision to the non-trading book.</p> <p>One respondent stated that when the structural FX risk is calculated on a consolidated basis, some trading book positions, such as FX swap, included in the hedging strategy may be considered to be of a structural nature. The hedging strategy implies that subsidiaries may directly manage their FX exposure in a currency that is different from their reporting currency through hedging operations on the market or against the parent company. Such hedging operations employ trading book instruments such as FX swap or cross-currency swap, which should be considered structural.</p>	<p>As mentioned above, the EBA is of the view that Article 352(2) of the CRR prevents positions that are not 'of a non-trading or structural nature' being eligible for the waiver under the guidelines. The EBA also interprets this passage of the CRR as a specification (i.e. 'of a non-trading, that is, of structural nature'); thus, trading book positions are not eligible for the waiver.</p> <p>It should be noted that the CRR requires institutions to include in the trading book positions for which they have a trading intent. Regardless of the nature of the financial instruments, and, in particular, regardless of their accounting treatment, institutions should include instruments that are taken for hedging the ratio and for which they do not have a trading intent in the non-trading book. For example, an institution may hedge the ratio by means of derivatives that, for</p>	<p>No amendments.</p>

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
		<p>example, according to the business model of the institution, will be kept until maturity. In this case, the competent authority should not force the institution to book those instruments in the trading book just on the basis that those instruments are allocated to the trading book in the accounting framework.</p>	
<p><b>Question 10.</b> Do you think that, by excluding positions that are non-eligible to be exempted, it will be easier for institutions to meet the requirement of keeping the sensitivity stable over time? Please elaborate.</p>	<p>For some respondents it is actually easier to keep the sensitivity stable over time.</p> <p>However, in general, respondents thought that the sensitivity formulas and range (with a 0.05 threshold) proposed are too restrictive. It was mentioned that the overall objective of achieving a harmonised EU interpretation and implementation of treatment of structural FX positions should be more robustly achieved by placing greater emphasis on the articulation of an entity's risk management strategy and internal governance framework.</p>	<p>See EBA analyses under Question 8.</p>	<p>Amendments to Section 7.</p>
<p><b>Question 11.</b> Is your institution currently required to keep the sensitivity of the ratio stable over time where requesting the permission referred to in Article 352(2)? If not, how do you justify the intention of hedging the ratio? Please elaborate.</p>	<p>No non-confidential responses were given for this question.</p> <p>One respondent stated that the requirement to keep the sensitivity stable over time is not in the level 1 text.</p>	<p>No non-confidential responses were given for this question. The comments received have been processed and analysed but cannot be reproduced here since they were all confidential.</p>	<p>No amendments.</p>

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
<p><b>Question 12.</b> Do you agree with the definition of the range in paragraph 27(d)? Do you think that 0.05 is an appropriate value?</p>	<p>All respondents disagreed with the definition of the range in paragraph 27(d). The main points of criticism are:</p> <ul style="list-style-type: none"> <li>• The range is too restrictive and it was proposed to increase it in size.</li> <li>• The range should be decided on a case-by-case basis and/or included in the risk management framework of the bank and may depend on the levels of FX rate volatilities, cost of hedging and sufficient market liquidity to execute hedges.</li> <li>• It seems counterproductive to ask an institution to stabilise the level of sensitivity of the ratio at a certain level if it is possible to lower and thus improve it. This is particularly relevant if the options are used to hedge the ratio.</li> <li>• It does not take RWAs/ratio development (new deals, sales, dividends, etc.) into account and thus may lead to unnecessary trading activities.</li> </ul> <p>For specific structural FX trades it was proposed that the transactions being exempted should be evidenced to prospectively reduce the adverse effect of change in the FX rate on the ratio.</p>	<p>The EBA acknowledges that respondents deem the sensitivity framework proposed in the consultation paper too strict and decided to amend Section 7.</p> <p>For more details, please see EBA analysis under Question 8.</p>	<p>Amendments to Section 7.</p>
<p><b>Question 13.</b> Could you provide a description of the risk management framework within which your institution operates for managing structural</p>	<p>No non-confidential responses were given providing a description of the risk management framework used.</p> <p>Although not strictly related to the question, one respondent argued that the change from ‘applying for exemption when relevant’ mode to ‘systematic</p>	<p>No non-confidential responses were given providing a description of the risk management framework used. The comments received have been processed and analysed but cannot be reproduced here since they were all confidential.</p>	<p>No amendments.</p>



Comments	Summary of responses received	EBA analysis	Amendments to the proposals
<p>positions that have been taken for hedging the ratio (e.g. how your institution currently computes the sensitivity of the ratio to changes in the exchange rate, the level of granularity at which the boundaries referred to in paragraph 27(i)(i) are defined, etc.)? Do you think that these guidelines are in line with the current risk management within which institutions operate for managing SFX positions? If not, which are the differences?</p>	<p>application' could make the framework non-operational. Another respondent claimed that the envisaged requirements are overly prescriptive and difficult to operationalise and not consistent with current risk management frameworks. That respondent argued that the overall objective of achieving a harmonised EU interpretation and implementation of treatment of structural FX positions should be more robustly achieved by placing greater emphasis on the articulation of an entity's risk management strategy and internal governance framework. The two respondents also proposed dropping the requirement for the inclusion of a limit for the maximum loss.</p>	<p>The EBA deems the framework included in the guidelines to be operational. In addition, the requirement on the maximum loss that is deemed acceptable has been kept; how that limit is set depends on the institution itself, as long as it is in line with all other requirements included in the guidelines (e.g. it has to be consistent with the risk appetite framework of the institution).</p>	
<p><b>Question 14.</b> Is it easy for institutions to 'transfer' the concept of net open position in the context of the internal model? What are the methodologies that institutions may use for excluding positions for which they may receive the permission referred to in Article 352(2) from their internal models?</p>	<p>Some respondents proposed that in order to foster a level playing field across institutions all calculations for obtaining the maximum open position and sensitivities should be based on the standardised approach methodology.</p> <p>One respondent highlighted a misalignment in terms of the reference period for computing the maximum open position and the own funds requirements.</p> <p>Some respondents highlighted some issues related to the application of the FX own funds requirements in the internal market risk model:</p>	<p>The EBA acknowledges the fact that currently almost no institutions include FX positions in the banking book in the internal model; therefore, market participants suggest using the standardised approach methodology to capitalise FX risk in the banking book.</p> <p>However, as stated above, the EBA does not deem it beneficial to force all institutions to use the standardised approach for computing the maximum open position. In particular, the maximum open position should be the one that offsets the sensitivity of the actual ratio to movements in the exchange rate; as such, it has to be computed using all figures that are used for obtaining the actual ratio (i.e. with IMA figures for IMA institutions).</p>	<p>No amendments.</p>

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	<ul style="list-style-type: none"> <li>• Treatment of exposures from entities that are not included in the internal model is not specified.</li> <li>• Requirements for actual and hypothetical back-testing are not clear.</li> <li>• Determination and application of the multiplier: back-testing over-shootings resulting from structural FX positions will impact the capital requirement for the trading book. As exposure from structural FX positions cannot be managed (reduced or closed) like a trading position, the connection should be avoided.</li> <li>• Identification of positions and changes in the data process requires time for implementation.</li> <li>• Diversification effects between the trading book capital charge and the capital charge for structural FX are not stable.</li> </ul>	<p>In addition, the EBA acknowledges that there may be some operational challenges related to the inclusion of structural positions in the internal model. However, it should be noted that institutions using the internal model approach are required to specify as part of the admissibility criteria the methodology they plan to use for doing so. Accordingly, the competent authority will be provided with all information that is needed for ensuring sound implementation of the guidelines. The methodology that institutions use for excluding the structural position from the net open position in the internal model will also play a relevant role in the approval of the waiver.</p>	
<p><b>Question 15.</b> What is the size of non-monetary items that are held at historical costs with respect to the size of the institution's balance sheet?</p>	<p>No non-confidential responses were provided for this question with respect to the size of non-monetary items that are held at historical cost.</p> <p>It was proposed to explicitly lay down partial or full exemptions of items held at historical cost for the calculation of the net open position, as hedging requirements from consolidated structural positions may not fully match the book values at the solo level.</p>	<p>No non-confidential responses were provided for this question stating the size of non-monetary items held at historical cost. The comments received have been processed and analysed but cannot be reproduced here since they were all confidential.</p> <p>The EBA would like to point out that the guidelines include a specific treatment for those items according to which:</p> <p>(i) institutions need to identify items that are held at historical cost and are of a structural nature;</p>	<p>No amendments.</p>

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
		<p>(ii) if the supervisors agree with the structural nature of those items, then they can be removed from the net open position without considering the effect of the cap.</p> <p>The above-mentioned treatment is applicable to any non-monetary items held at historical cost.</p> <p>The treatment of items held at historical cost with respect to their inclusion in the FX charge in the first place will be provided in the context of the RTS on FX and commodity risk in the banking book.</p>	
<p><b>Question 16.</b> Do you think that the formulas presented above provide a good estimate of the position that is offsetting the sensitivity of the ratio with respect to changes in the exchange rate? If no, why? Are there any adjustments that you would recommend? Please elaborate.</p>	<p>Some respondents agreed that the formulas do provide a good estimate.</p> <p>It was also mentioned that, depending on the specific situation, positions arising from minority interests should be included in paragraphs 34 and 35 of the guidelines.</p> <p>Some respondents claimed that there are some underlying assumptions in the formulas and the examples that are theoretical, and highlighted the following:</p> <ul style="list-style-type: none"> <li>The calculation of the maximum open position in a given currency assumes a move of that currency against the reporting currency. In fact, a move of that currency against all the other currencies is more correct, especially where the contemplated capital base includes various items in different currencies. For instance, the total capital (CET1, AT1 and T2) generally</li> </ul>	<p>The EBA kept the formulas unchanged.</p> <p>With respect to the treatment of deductions, the EBA decided to keep the examples as simple as possible in order to show the core elements of the structural FX framework. However, the treatment of deductions is included in the main text of the proposed guidelines; hence, that case is covered.</p> <p>The EBA acknowledges that some institutions may actually build a strategy aimed at hedging a target ratio. The amendments to Section 7 allow institutions to consider events that, for example, may occur in the future when defining their strategy. However, when calculating the own funds requirements for FX risk, institutions are required to use the actual ratio to ensure a level playing field and harmonisation within the EU.</p> <p>The EBA recognises the point made by some respondents with respect to minority shareholders</p>	<p>Amendments to Section 7 and Section 8.</p>

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	<p>includes instruments (AT1 and T2) that are issued in a number of currencies.</p> <ul style="list-style-type: none"> <li>The reference ratio is the current ratio. In many instances, a more appropriate ratio is a target ratio, which is generally between the required ratio and the current ratio, and sometimes above the current ratio (for instance, when a capital increase is contemplated).</li> <li>The examples given in the consultation paper assume no deductions and no minority shareholders.</li> <li>The formulas assume that the revaluation on the open positions fully translates into an equal variation of CET1. Consequently, the items are regarded as fully fungible. This is not the case in practice; frictions and drags may arise in certain instances, notably for tax or regulatory reasons.</li> </ul> <p>One respondent mentioned that the formula should factor in each currency, as well as correlation and diversification effects.</p> <p>It was mentioned that the formulas presented in the guidelines provide a quantitative definition of the capital ratio sensitivity concerning a specific FX rate. To this end, they require some simplifying assumptions and a consistent effort to collect all data. The application mechanism of the obtained values seems to be excessively rigid, meaning that any change in the quantities due to FX rate</p>	<p>and included a specification in the guidelines to address that case.</p> <p>The EBA thinks that the effect of tax does not have to be considered. In this way the own funds requirements for FX risk do not depend on where the institution is located. In addition, not considering tax makes the framework much simpler.</p> <p>The EBA believes that the maximum open position cannot be assumed to be constant over time, as FX rate fluctuations actually do have an impact on the capital ratio volatility.</p> <p>The EBA believes that no simplifying assumptions are applied to derive the maximum open position formulas. Indeed, the Taylor approximation used to derive the formula is consistent with the fact that the net open position (independent of whether the structural FX provision is applied or not) is also based only on a linear approximation. The simplifying assumptions behind the definition of the net open position are specified in Article 352(1) and are not discussed in these guidelines.</p> <p>Furthermore, regarding the statement concerning the recursive structure of the maximum open position, the EBA would like to point out that the right-hand side of the equation for the maximum open position does not depend on the own funds requirements for FX risk regarding the specific currency.</p> <p>Finally, the EBA introduced some specific provisions allowing institutions to simplify the formula provided</p>	

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	<p>fluctuations could imply a change in the optimal position of the bank.</p> <p>One respondent mentioned that, from a mathematical point of view, many of the formulas are derived as approximations. In fact, in the equation for the optimal position, the right-hand side of the equation depends itself on the optimal position, which makes the equation recursive. It should be clarified if the quantities on the right-hand side of the equation are to be considered the current values.</p>	<p>in the guidelines as long as those simplifications do not result in an overestimation of the maximum open position.</p>	
<p><b>Question 17.</b> Do you think that it is operationally feasible to compute the maximum open position and the sensitivity on a monthly basis?</p>	<p>Several respondents said that a monthly reporting requirement for the risk figures is not proportional to the risk and is overly burdensome. The main reasons are as follows:</p> <ul style="list-style-type: none"> <li>• given the structural nature of these positions, there is no added benefit of reporting more frequently than quarterly;</li> <li>• consolidated data are available only on a quarterly basis;</li> <li>• COREP reporting is done quarterly.</li> </ul> <p>Some responded that the consultation paper requires the inclusion of all FX-sensitive RWAs. This implies a high operational effort for some parts (e.g. CVA) although the contribution may be immaterial. It is therefore proposed to include a paragraph stating that banks need to include all material contributions. Materiality can be assessed as part of</p>	<p>The EBA acknowledges the fact that most market participants responded that a monthly reporting requirement is overly burdensome.</p> <p>The EBA decided to amend the guidelines and to require institutions to report quarterly, which, however, should include the monthly figures.</p> <p>The EBA acknowledges the fact that depending on the actual positions of an institution some parts of the formula may have only a limited impact on the final result. The EBA addressed this issue by allowing institutions to simplify the formula provided in the guidelines as long as those simplifications do not result in an overestimation of the maximum open position.</p>	<p>Amendments to Section 7 and Section 8.</p>

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	the waiver application and regularly (e.g. yearly) in the validation process.		
<p><b>Question 18.</b> Do you currently include Additional Tier 1 instruments, and Tier 2 instruments that are issued in the foreign currency in the net open position referred to in Article 352(2)? Please elaborate.</p>	<p>One respondent said that that only equity instruments funding assets in the foreign currency should be excluded from the net open currency position.</p> <p>Two respondents mentioned that the eligibility of AT1 and T2 instruments in the net open currency position of a credit institution depends on the instrument's classification as equity or debt. In case the instrument is accounted for as equity and the bank aims to economically hedge against FX risk, it may retain the FX cash proceeds from the issuance, giving raise to capital ratio volatility. To avoid this, some banks sell the foreign currency for the reporting currency, leaving them economically exposed to FX in case the AT1 securities are called (affecting the numerator of the capital ratio).</p> <p>T2 securities are typically debt accounted and are included as part of the net open currency position. This would also be the case for debt-accounted AT1 securities.</p>	<p>The EBA acknowledges that institutions are interpreting the eligibility of AT1 and T2 instruments differently depending on the accounting classification of such instruments.</p> <p>The EBA stands ready to provide prudential clarifications around this aspect, which is, however, relevant to all institutions (i.e. also those not applying for the structural FX waiver) and accordingly is not addressed as part of these guidelines.</p> <p>When it comes to the exemption of those items from the net open position, the EBA thinks that the treatment envisaged in the guidelines is broad enough to capture all kinds of cases.</p>	No amendments.
<p><b>Question 19.</b> What is in percentage the amount of Additional Tier 1 instruments, and Tier 2 instruments that your institution issued in foreign currency with respect to</p>	<p>Just one non-confidential answer was received for this question.</p> <p>This respondent took a different materiality approach for these instruments (AT1 and T2), considering RWAs as the denominator of the indicator, but the methodology of the approach, including the number of banks in the sample, was</p>	<p>No non-confidential responses were received stating the percentage asked for in the question. The comments received have been processed and analysed but cannot be reproduced here since they were all confidential.</p>	No amendments.

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
the total amount of the own funds of your institution?	not specified. The figures reported are 1.5% and 2% for AT1 and T2, respectively. Finally, the respondent also suggested that leverage ratio-constrained banks (typical of bigger, more complex banks) have incentives to issue AT1 instruments in foreign currency to comply with the CRR2 minimum 3% leverage ratio requirement.		
<b>Question 20.</b> What is the percentage of the amount of Additional Tier 1 instruments, and Tier 2 instruments that your institution issued in a foreign currency with respect to the net open position that your institution has in that foreign currency?	No non-confidential responses were received stating the percentage asked for in the question.	No non-confidential responses were received stating the percentage asked for in the question. The comments received have been processed and analysed but cannot be reproduced here since they were all confidential.	No amendments.
<b>Question 21.</b> Is there anything in the approach outlined in these guidelines that could create issues of compatibility with the treatment foreseen in any non-EU jurisdictions in which EU institutions operate? If so, please elaborate.	<p>Some respondents did not focus on the question itself, diverging to more general concerns other than compatibility issues of the foreseen treatment compared with other jurisdictions. Concerns were raised about the level playing field with regard to non-EU institutions.</p> <p>The majority of banks did not identify any issues of compatibility compared with other (non-EU) jurisdictions.</p> <p>Outside the scope of this question, some additional issues were raised:</p> <ul style="list-style-type: none"> <li>• Very formulaic and overly prescriptive/stringent approach. Suggested</li> </ul>	None of the comments received around this question were related to issues of compatibility that these guidelines may create with the treatment foreseen in non-EU jurisdictions. Other comments received as part of this question have been addressed (where appropriate), as outlined in the general comments section of this table or in the context of the feedback received for other questions.	No amendments.

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	<p data-bbox="584 328 1099 424">more flexibility for institutions in their FX management according to their governance arrangements approved by management.</p> <ul data-bbox="539 448 1099 552" style="list-style-type: none"><li data-bbox="539 448 1099 552">• Only possible to hedge the ratio at the consolidated level (suggesting an automatic waiver at the solo level).</li></ul>		





## 4.3 Annex I: Derivation of the maximum open position

### Derivation of the formulas for an institution hedging the CET1 ratio

The reasoning below is presented in the context of an institution applying for the structural FX treatment to recognise the hedging effect of FX positions on the CET1 ratio.

For the purpose of calculating the maximum open position (*MaxOP*), as described in the background section, institutions should exclude the own funds requirements for FX risk (*FX – OFR*) for all positions in the currency of the positions for which they seek the waiver from the total risk exposure amount, as defined in Article 92 of the CRR. Accordingly, the ratio to consider for calculating the maximum open position ( $CR_{MaxOP}$ ) is defined as:

$$CR_{MaxOP} \equiv \frac{CET1}{RWA_{NoFXFC}} \quad (1)$$

where:

*CET1* is the Common Equity Tier 1, as defined under Part Two – Title I of the Capital Requirement regulation (CRR);

$RWA_{NoFXFC}$  is the total risk exposure amount, as defined in Article 92 of the CRR, excluding the *FX – OFR* for the currency of the positions for which the institution seeks the waiver.

Making explicit the dependence of the *CET1* on the exchange rate  $FX_{FC}$  and assuming *CET1* to be regular around  $FX_{FC_0}$ :

$$\begin{aligned} CET1(FX_{FC}) &= \sum_{j=0}^{\infty} C_j \cdot (FX_{FC} - FX_{FC_0})^j \\ &= C_0 + C_1 \cdot (FX_{FC} - FX_{FC_0}) + \sum_{j=2}^{\infty} C_j \cdot (FX_{FC} - FX_{FC_0})^j \quad (2) \end{aligned}$$

where:

- (i)  $FX_{FC}$  is the exchange rate between the reporting currency and the foreign currency for which the institution is calculating the maximum open position that can be exempted (i.e. one unit of foreign currency corresponds to  $FX_{FC}$  units of the reporting currency);
- (ii)  $FX_{FC_0}$  is the value of  $FX_{FC}$  at the moment of the calculation of *MaxOP*;
- (iii) the coefficients  $C_j$  are not dependent on  $FX_{FC}$ .

Accordingly, around  $FX_{FC_0}$ ,  $CET1$  can be approximated as:

$$CET1(FX_{FC}) \sim C_0 + C_1 \cdot (FX_{FC} - FX_{FC_0}) \quad (3)$$

The first derivative of  $CR_{MaxOp}$  defined in (1) is:

$$\frac{\partial CR_{MaxOp}}{\partial FX_{FC}} = \frac{\left( \frac{\partial CET1}{\partial FX_{FC}} \cdot (RWA_{NoFX_{FC}}) - \frac{\partial RWA_{NoFX_{FC}}}{\partial FX_{FC}} \cdot CET1 \right)}{RWA_{NoFX_{FC}}^2} \quad (4)$$

Considering the approximation in (3), it holds that  $\frac{\partial CET1}{\partial FX_{FC}} = C_1$ , and accordingly the sensitivity in (4) is:

$$\frac{\partial CR_{MaxOp}}{\partial FX_{FC}} = \frac{C_1 \cdot RWA_{NoFX_{FC}} - \frac{\partial RWA_{NoFX_{FC}}}{\partial FX_{FC}} \cdot CET1}{RWA_{NoFX_{FC}}^2} \quad (5)$$

Setting the derivative to zero, a condition neutralising the sensitivity of  $CR_{MaxOp}$  with respect to  $FX_{FC}$  is obtained:

$$C_1^{Optimal} = \frac{CET1 \cdot \frac{\partial RWA_{NoFX_{FC}}}{\partial FX}}{RWA_{NoFX_{FC}}} \quad (6)$$

where  $C_1^{Optimal}$  is the value of  $C_1$  neutralising the sensitivity of  $CR_{MaxOp}$  with respect to  $FX_{FC}$ .

The net open position ( $NOP$ ), calculated in accordance with Article 352(2), can be written as the sum of the long and short FX positions stemming from items whose gains and losses can be reflected in the  $CET1$  and the sum of the long and short FX positions stemming from items whose gains and losses cannot be reflected in the  $CET1$  (which, in any case, have been included in the calculation of the net open position). Accordingly:

$$NOP = OP_{CET1} + OP_{ExCET1} \quad (7)$$

where:

- $OP_{CET1}$  is the resulting net open position stemming from items that lead to gains or losses that can be reflected in the  $CET1$ ;

- $OP_{ExCET1}$  is the resulting net open position stemming from items that lead to gains or losses that cannot be reflected in the  $CET1$ <sup>20</sup>.

It should be noted now that  $OP_{CET1}$  is a good approximation of  $C_1$ . Indeed, the open position stemming from items whose gains or losses can be reflected in the  $CET1$  represents a good approximation of the coefficient measuring the impact on the  $CET1$  of small changes in the exchange rate. In other words, the open position  $OP_{CET1}$  is the delta sensitivity to the FX rate, and  $C_1$  represents such delta as it is the coefficient that, multiplied by a change in the exchange rate, provides (to the first order) the gains/losses that the institution's portfolio faces following such a change. For example, if  $OP_{CET1}$  increases by USD 10 million under a shock of 1 basis point in the euro to US dollar exchange rate, then  $CET1$  increases by USD 10 million as well.

Combining that:

- $C_1^{Optimal}$  is the value of  $C_1$  for which the sensitivity of the ratio with respect to changes in the relevant exchange rate is equal to zero;
- $C_1 \cong OP_{CET1}$  following the reasoning in the previous paragraph;

It follows that, if the institution has an open position stemming from items whose gains or losses can be reflected in the  $CET1$  that is equal to  $C_1^{Optimal}$ , then  $CR_{MaxOp}$  is not sensitive (to the first order) to changes in the exchange rate. This can be expressed as follows:

$$\text{If } OP_{CET1} = C_1^{Optimal} \text{ then } \frac{\partial CR_{MaxOp}(FX_{FC})}{\partial FX_{FC}} = 0 \text{ in } FX_{FC} = FX_{FC_0}$$

Accordingly,  $C_1^{Optimal}$  is the size of the open position capping the size of the long structural open position that can be excluded from the net open position as it represents the amount neutralising the sensitivity of  $CR_{MaxOp}$  to changes in the exchange rate.

As a result, these guidelines require institutions to calculate the maximum open position ( $MaxOP$ ) that can be recognised as structural, as defined by the following formula:

$$MaxOP = CET1 * \frac{RWA_{NoFX_{FC}}(1.01 * FX_{FC_0}) - RWA_{NoFX_{FC}}(FX_{FC_0})}{0.01 * FX_{FC_0}} \quad (*)$$

where  $MaxOP$  is expressed in the foreign currency  $FC$ .

<sup>20</sup> in general, these are items that have been deducted from the  $CET1$  capital of the institution. However, there may be other cases of items that are included in the net open position but whose gains or losses cannot be reflected in  $CET1$ , as noted by some respondents during the consultation.

In addition, considering that FX positions stemming from items whose gains or losses cannot be reflected in the CET1 capital, which, in any case, have been included in the calculation of the net open position (i.e. those included in the calculation of  $OP_{EXCET1}$ ), do not affect the way the CET1 moves with respect to FX changes, they can be excluded from the net open position regardless of the cap imposed in (\*).

It should be noted that the FRTB clarifies that ‘No FX risk capital requirement need to apply to positions related to items that are deducted from a bank’s capital when calculating its capital base.’ The CRR/CRR2 does not include such a specification and it appears from Article 352(2) that there might be some positions stemming from items deducted from the CET1 but included in the NOP. As a result, the provision included in the previous paragraph has been included in the guidelines.

Combining (5) with the definition of  $C_1^{Optimal}$  in (6), it follows that:

$$\frac{\partial CR_{MaxOp}}{\partial FX_{FC}} = \frac{C_1 \cdot RWA_{NoFX_{FC}} - C_1^{Optimal} \cdot RWA_{NoFX_{FC}}}{RWA_{NoFX_{FC}}^2} \quad (8)$$

And since  $C_1 \cong OP_{CET1}$  and  $C_1^{Optimal} \cong MaxOP$  it holds that:

$$\frac{\partial CR_{MaxOp}}{\partial FX_{FC}} = \frac{OP_{CET1} - MaxOP}{RWA_{NoFX_{FC}}} \quad (9)$$

The sensitivity in (9) can be written as:

$$\frac{\partial CR_{MaxOp}}{\partial FX_{FC}} = \frac{S_{OP_{CET1}} + NS_{OP_{CET1}} - MaxOP}{RWA_{NoFX_{FC}}} \quad (10)$$

where:

- $S_{OP_{CET1}}$  is the resulting open position stemming from items whose gains and losses can be reflected in the CET1 and corresponding to positions that are suitable to be exempted.
- $NS_{OP_{CET1}}$  is the resulting open position stemming from items whose gains and losses cannot be reflected in the CET1 and corresponding to positions that are not suitable to be exempted.

Removing the effect of positions that cannot be exempted from the open position in the numerator of the sensitivity, the measure that institutions are required to report for the purpose of the ongoing monitoring is obtained:

$$Sensitivity = \frac{S_{OP_{CET1}} - MaxOP}{RWA_{NoFX_{FC}}} \quad (**)$$

### Derivation of the formulas for an institution hedging the T1 ratio

The reasoning below is presented in the context of an institution applying for the structural FX treatment to recognise the hedging effect of FX positions on the T1 ratio<sup>21</sup>.

For the purpose of calculating the maximum open position (*MaxOP*), as described in the background section, institutions should exclude the own funds requirements for FX risk (*FX – OFR*) for the currency of the positions for which they seek the waiver from the total risk exposure amount, as defined in Article 92 of the CRR. Accordingly, the ratio to consider for calculating the maximum open position ( $CR_{MaxOP}$ ) is defined as:

$$CR_{MaxOP} \equiv \frac{Tier\ 1}{RWA_{NoFXFC}} \quad (1a)$$

where:

*Tier 1* is the Tier 1 as defined under Part Two – Title I of the CRR;

$RWA_{NoFXFC}$  is the total risk exposure amount, as defined in Article 92 of the CRR, excluding the *FX – OFR* for the currency of the positions for which the institution seeks the waiver.

Making explicit the dependence of the T1 on the exchange rate  $FX_{FC}$  and assuming T1 to be regular around  $FX_{FC_0}$ :

$$\begin{aligned} Tier\ 1(FX_{FC}) &= \sum_{j=0}^{\infty} T_j \cdot (FX_{FC} - FX_{FC_0})^j \\ &= T_0 + T_1 \cdot (FX_{FC} - FX_{FC_0}) + \sum_{j=2}^{\infty} T_j \cdot (FX_{FC} - FX_{FC_0})^j \quad (2a) \end{aligned}$$

where:

- (i)  $FX_{FC}$  is the exchange rate between the reporting currency and the foreign currency for which the institution is calculating the maximum open position that can be exempted (i.e. one unit of foreign currency corresponds to  $FX_{FC}$  units of the reporting currency);
- (ii)  $FX_{FC_0}$  is the value of  $FX_{FC}$  at the moment of the calculation of *MaxOP*;
- (iii) the coefficients  $T_j$  are not dependent on  $FX_{FC}$ .

The T1 is the sum of CET1 and AT1. Accordingly, the series in (2a) can be written as:

<sup>21</sup> It should be noted that the same reasoning can be applied in the context of the total capital ratio.

$$\begin{aligned}
 Tier\ 1(FX_{FC}) &= CET1(FX_{FC}) + AT1(FX_{FC}) = \sum_{j=0}^{\infty} (C_j + AT_j) \cdot (FX_{FC} - FX_{FC_0})^j \\
 &= (C_0 + AT_0) + (C_1 + AT_1) \cdot (FX_{FC} - FX_{FC_0}) + \sum_{j=2}^{\infty} (C_j + AT_j) \cdot (FX_{FC} - FX_{FC_0})^j \quad (3a)
 \end{aligned}$$

where  $C_j$  and  $AT_j$  are the coefficients of the Taylor expansion for  $CET1$  and  $AT1$  respectively.

Accordingly, around  $FX_{FC_0}$ ,  $Tier\ 1$  can be approximated as:

$$Tier\ 1 \sim (C_0 + AT_0) + (C_1 + AT_1) \cdot (FX_{FC} - FX_{FC_0}) \quad (4a)$$

The first derivative of  $CR_{MaxOp}$  defined in (1a) is:

$$\frac{\partial Tier1}{\partial FX_{FC}} = \frac{\left( \frac{\partial Tier1}{\partial FX_{FC}} \cdot (RWA_{NoFX_{FC}}) - \frac{\partial RWA_{NoFX_{FC}}}{\partial FX_{FC}} \cdot Tier1 \right)}{RWA_{NoFX_{FC}}^2} \quad (5a)$$

Considering the approximation in (4a), it holds that  $\frac{\partial Tier1}{\partial FX_{FC}} = C_1 + AT_1$ , and accordingly the sensitivity in (5a) is:

$$\frac{\partial Tier1}{\partial FX_{FC}} = \frac{(C_1 + AT_1) \cdot RWA_{NoFX_{FC}} - \frac{\partial RWA_{NoFX_{FC}}}{\partial FX_{FC}} \cdot CET1}{RWA_{NoFX_{FC}}^2} \quad (5a)$$

Setting the derivative to zero, a condition neutralising the sensitivity of  $CR_{MaxOp}$  with respect to  $FX_{FC}$  is obtained:

$$C_1^{Optimal} = \frac{CET1 \cdot \frac{\partial RWA_{NoFX_{FC}}}{\partial FX}}{RWA_{NoFX_{FC}}} - AT_1 \quad (6a)$$

where  $C_1^{Optimal}$  is the value of  $C_1$  neutralising the sensitivity of  $CR_{MaxOp}$  with respect to  $FX_{FC}$ .

The net open position ( $NOP$ ), calculated in accordance with Article 352(2), can be written as the sum of the long and short FX positions stemming from items whose gains and losses can be reflected in  $CET1$  and the sum of the long and short FX positions stemming from items whose gains and losses cannot be reflected in  $CET1$  (which, in any case, have been included in the calculation of the net open position). Accordingly:

$$NOP = OP_{CET1} + OP_{ExCET1} \quad (7a)$$

where:

- $OP_{CET1}$  is the resulting net open position stemming from items that lead to gains or losses that can be reflected in the  $CET1$ .
- $OP_{ExCET1}$  is the resulting net open position stemming from items that lead to gains or losses that cannot be reflected in the  $CET1$ <sup>22</sup>.

It should be noted now that  $OP_{CET1}$  is a good approximation of  $C_1$ . Indeed, the open position stemming from items whose gains or losses can be reflected in the  $CET1$  represents a good approximation of the coefficient measuring the impact on the  $CET1$  of small changes in the exchange rate. In other words, the open position  $OP_{CET1}$  is the delta sensitivity to the FX rate, and  $C_1$  represents such delta as it is the coefficient that, multiplied by a change in the exchange rate, provides (to the first order) the gains/losses that the institution's portfolio faces following such a change. For example, if  $OP_{CET1}$  increases by USD 10 million under a shock of 1 basis point in the euro to US dollar exchange rate, then  $CET1$  increases by USD 10 million as well.

Similarly,  $AT_1$  represents the delta sensitivity to the FX rate of AT1 instruments; in other words,  $AT_1$  represents the coefficient that, multiplied by the value of a change in the exchange rate, provides (to the first order) the appreciation/depreciation of the AT1 instruments following such a change.

Combining that:

- $C_1^{Optimal}$  is the value of  $C_1$  for which the sensitivity of the ratio with respect to changes in the relevant exchange rate is equal to zero;
- $C_1 \cong OP_{CET1}$  following the reasoning in the previous paragraph;

It follows that if the institution has an open position stemming from items whose gains or losses can be reflected in the  $CET1$  that is equal to  $C_1^{Optimal}$ , then  $CR_{MaxOp}$  is not sensitive (to the first order) to changes in the exchange rate. This can be expressed as follows:

$$\text{If } OP_{CET1} = C_1^{Optimal} \text{ then } \frac{\partial CR_{MaxOp}(FX_{FC})}{\partial FX_{FC}} = 0 \text{ in } FX_{FC} = FX_{FC_0}$$

Accordingly,  $C_1^{Optimal}$  is the size of the open position capping the size of the long structural open position that can be excluded from the net open position as it represents the amount neutralising the sensitivity of  $CR_{MaxOp}$  to changes in the exchange rate.

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<sup>22</sup> in general, these are items that have been deducted from the CET1 capital of the institution. However, there may be other cases of items that are included in the net open position but whose gains or losses cannot be reflected in the CET1, as noted by some respondents during the consultation.



As a result, these guidelines require institutions to calculate the maximum open position (*MaxOP*) that can be recognised as structural, as defined by the following formula:

$$MaxOP = Tier1 * \frac{RWA_{NoFXFC}(1.01 \cdot FX_{FC_o}) - RWA_{NoFXFC}(FX_{FC_o})}{0.01 \cdot FX_{FC_o}} - AT_1 (* a)$$

where *MaxOP* is expressed in the foreign currency *FC*.

## 4.4 Annex II: stylised examples of the application of the structural FX provision

*In the examples below, the values of the items have already been translated into EUR. Accordingly, even if an item is denominated in, for example, US dollars (and is therefore subject to the EUR/USD risk), its value has already been converted to euro.*

*MaxOP and S\_OP have also already been translated into the reporting currency (i.e. EUR). Example 10 shows in a simplified manner how the guidelines are expected to be applied by institutions and competent authorities.*

**Example 1: identification of positions of types A and B at solo level for an institution with EUR as the reporting currency and assuming all positions to be banking book positions**

	Value in EUR		Value in EUR
Assets 1 in EUR	400	Liabilities in EUR	450
Assets 2 in EUR	100	Liabilities in GBP	20
Assets 3 in GBP – participation	20		
Assets 4 in GBP	30		
		CET1 in EUR	80

*Assets and liabilities in blue do not bear FX risk for an institution reporting in EUR.*

*The FX position corresponding to an asset in green is of type A, since the item bearing FX risk is an investment in the subsidiary. Assets in yellow are positions of type B, as they are not investments in a subsidiary.*

**Example 2: identification of positions of types A and B at the consolidated level**

*Parent bank at the solo level reporting in EUR:*

	Value in EUR		Value in EUR
Assets in EUR	400	Liabilities in EUR	450
Assets in EUR	100		
Assets in GBP – participation	20		
Assets in GBP	30		
		CET1 in EUR	100

Subsidiary at solo level reporting in GBP:

	Value in EUR		Value in EUR
Assets in GBP	300	Liabilities in GBP	200
Assets in USD	100	Liabilities in USD	20
		CET1 in GBP	180

Institution at consolidated level reporting in EUR:

	Value in EUR		Value in EUR
Assets in EUR	400	Liabilities in EUR	450
Assets in EUR	100		
Assets in GBP	300	Liabilities in GBP	200
Assets in GBP	30		
Assets in USD	100	Liabilities in USD	20
		CET1 in EUR	260

Assets and liabilities in blue do not bear FX risk for an institution reporting in EUR.

Assets and liabilities in green are assets stemming from the investment of the parent bank in the subsidiary, and the currency of the corresponding FX positions coincides with the currency of the subsidiary at solo level (i.e. GBP). Accordingly, such FX positions are positions of type A.

All other FX positions, corresponding to assets and liabilities in yellow, are of type B.

**Example 3: identification of positions of types A and B at consolidated level**

Parent bank P owns subsidiary S1, which owns subsidiary S2.

Parent bank P reports in EUR at solo level, subsidiary S1 reports in GBP at solo level and subsidiary S2 reports in DKK at solo level.

The group 'P + S1 + S2' reports in EUR at consolidated level. The group 'S1 + S2' reports in GBP at sub-consolidated level.

Assumption: all positions are banking book positions.

Parent bank at solo level reporting in EUR:

	Value in EUR		Value in EUR
Assets in EUR	400	Liabilities in EUR	300
Assets in GBP – participation in S1	150		
		CET1 in EUR	250

Subsidiary S1 at solo level reporting in GBP:

	Value in EUR		Value in EUR
Assets in GBP	300	Liabilities in GBP	200
Assets in DKK – participation in S2	100		
		CET1 in GBP	200

Subsidiary S2 at solo level reporting in DKK:

	Value in EUR		Value in EUR
Assets in DKK	200	Liabilities in DKK	100
		CET1 in DKK	100

Group (P + S1 + S2) at consolidated level reporting in EUR:

	Value in EUR		Value in EUR
Assets in EUR	400	Liabilities in EUR	300
Assets in GBP	300	Liabilities in GBP	200
Assets in DKK	200	Liabilities in DKK	100
		CET1 in EUR	300

FX positions corresponding to assets and liabilities in green are positions of type A.

Assets and liabilities in blue do not bear FX-risk at consolidated level.

Group (S1 + S2) at sub-consolidated level reporting in GBP:

	Value in EUR		Value in EUR
Assets in GBP	300	Liabilities in GBP	200
Assets in DKK	200	Liabilities in DKK	100
		CET1 in GBP	200

FX positions corresponding to assets and liabilities in green are positions of type A.

Assets and liabilities in blue do not bear FX risk at sub-consolidated level.

**Example 4: Computation of the maximum open position**

Suppose that the institution is hedging the CET1 ratio and that the competent authority identified all positions as eligible to be exempted. In addition, for the sake of simplicity, it is assumed that no own funds requirements exist for market risk (except FX risk), operational risk, counterparty credit risk and CVA risk.

	Value in EUR		Value in EUR
Assets 1 in EUR	400	Liabilities in EUR	450
Assets 2 in EUR	100	Liabilities in GBP	40
Assets 3 in GBP	20		
Assets 4 in GBP	40		
		CET1 in EUR	70

The risk weights for credit risk (and corresponding RWAs) are those reported below:

Type of asset	Risk weight	RWA for credit risk
1	0.75	300
2	0.3	30
3	0.5	10
4	0.4	16

Accordingly:

Total RWAs (without FX charge)	356
CET1	70
CET1 ratio (without FX charge)	0.196629213

Applying the formula for the calculation of the maximum open position:

$$\text{MaxOP} = \text{EUR } 5.1123$$

As a result<sup>23</sup>:

Net open position structural	20
Max. open position	5.112359551
Capital charge for FX	14.88764045

<sup>23</sup> Explanation of the figures:

Net open position in GBP (value in EUR) = Assets 3 in GBP + Assets 4 in GBP – liabilities in GBP = 20 + 40 – 40 = 20

Capital charge for FX = net open position structural – Max open position = 20 - 5.112359551 = 14.88764045

*In the following it is proved that the capital ratio remains constant if the open position in the foreign currency equals the maximum open position. To prove this, the open position in the foreign currency is partially closed, increasing the value of the liabilities in the foreign currency and decreasing by the same amount the liabilities in the domestic currency.*

	Value in EUR		Value in EUR
Assets 1 in EUR	400	Liabilities in EUR	435.1123596
Assets 2 in EUR	100	Liabilities in GBP	54.88764045
Assets 3 in GBP	20		
Assets 4 in GBP	40		
		CET1 in EUR	70

'New' net open position	5.112359551
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*The CET1 ratio (without FX charge) has not changed. Suppose now a shock of 20% is applied to the exchange rate (e.g. following appreciation of the foreign currency). Accordingly, the 'new' balance sheet is as follows:*

	Value in EUR		Value in EUR
Assets 1 in EUR	400	Liabilities in EUR	435.1123596
Assets 2 in EUR	100	Liabilities in GBP	65.86516854
Assets 3 in GBP	24		
Assets 4 in GBP	48		
		CET1 in EUR	71.02247191

*As a result:*

Total RWAs (without FX charge)	361.2
CET1 ratio (without FX charge)	0.196629213

*Accordingly, the CET1 ratio is actually constant if the open position in the foreign currency equals the maximum open position. It is worth mentioning that, where the open position equals the maximum open position, the CET1 ratio without FX charge actually coincides with the 'real' CET1 since following the permission of the competent authority the FX charge is equal to zero. In this sense, the 'real' CET1 is constant with respect to changes in the exchange rate.*

#### **Example 5: Computation of the maximum open position for an institution hedging the T1 ratio**

*Suppose that the institution hedges the T1 ratio and that part of the T1 instruments has been issued in the foreign currency and the remaining parts have been issued in the reporting currency. In*

addition, for the sake of simplicity, it is assumed that no own funds requirements exist for market risk (except FX risk), operational risk, counterparty credit risk and CVA risk.

	Value in EUR		Value in EUR
Assets in EUR	400	Liabilities in EUR	300
Assets in GBP	300	Liabilities in GBP	200
		Liabilities in EUR – T1	25
		Liabilities in GBP – T1	25
		CET1 in EUR	150

The 'Liabilities in EUR – T1' and 'Liabilities in GBP – T1' are the T1 instruments issued in euro and pounds sterling respectively.

Suppose the risk weight for credit risk is 0.8 for assets in EUR and 0.5 for assets in GBP. The total RWAs (without FX charge) are EUR 470<sup>24</sup>. The T1 ratio is 0.42553.

Computing the maximum open position with the formula applicable to institutions hedging the T1 ratio (and translating its value in the reporting currency):

$$\text{MaxOP} = \text{EUR } 38.83$$

Again, it is checked that the T1 ratio is constant if the open position of the institution equals the maximum open position. As in Example 4, the open position (75 = 300 – 200 – 25) in the foreign currency is partially closed, increasing the value of the liabilities in the foreign currency and decreasing by the same amount the liabilities in the domestic currency.

	Value in EUR		Value in EUR
Assets in EUR	400	Liabilities in EUR	263.8297872
Assets in GBP	300	Liabilities in GBP	236.1702128
		Liabilities in EUR – T1	25
		Liabilities in GBP – T1	25
		CET1 in EUR	150

The 'new' open position equals the maximum open position, i.e. it is equal to EUR 38.82978723. The T1 ratio is equal to that calculated above, i.e. 0.42553.

<sup>24</sup> RWAs with no FX charge = 0.8 \* 400 + 0.5 \* 300 = 470.

Applying a shock of 25% to the exchange rate, the 'new' balance sheet is as follows:

	Value in EUR		Value in EUR
Assets in EUR	400	Liabilities in EUR	263.8297872
Assets in GBP	375	Liabilities in GBP	295.212766
		Liabilities in EUR – T1	25
		Liabilities in GBP – T1	31.25
		CET1 in EUR	159.7074468

As a result, the RWAs (without FX charge) are EUR 507.5 and the T1 is 215.9574468.

Accordingly, the T1 ratio is 0.42553, i.e. the ratio did not change after the shock was applied to the exchange rate.

**Example 6: Calculation of the sensitivity as prescribed in the guidelines for monitoring purposes**

Suppose that the competent authority assesses that all positions in the banking book are eligible to be exempted. Positions in the trading book are not suitable for the exemption because one of the minimum requirements for a position to be exempted is that it belongs to the banking book.

	Value in EUR		Value in EUR
Assets in EUR	10 000	Liabilities in EUR	8 000
Assets in GBP (BB)	2000	Liabilities in GBP (BB)	1000
Assets in GBP (TB)	1000	Liabilities in GBP (TB)	0
		CET1 in EUR	4 000

Suppose in this case the asset in the trading book to be a UK index, subject to equity risk and FX charge (and no specific risk), and all banking book positions attract only credit risk, with a corresponding RW of 75%. It follows that:

RWAs (without FX charge)	$0.75 * 10\ 000 + 0.75 * 2\ 000 + 1\ 000 * 0.08 * 12.5 = 10\ 000$
CET1 ratio (without FX charge)	0.4

In addition, it follows (using the formula included in the guidelines) that the maximum open position that can be exempted has a size equal to 1 000. Accordingly:



$$\text{Sensitivity} = \frac{S_{OP} - \text{MaxOP}}{RWA_{NoFX_{FC}}} = 0$$

This because the maximum open position equals the open position that is eligible to be exempted. Now, consider that a shock of 10% is applied to the exchange rate. The 'new' balance sheet is as follows:

	Value in EUR		Value in EUR
Assets in EUR	10 000	Liabilities in EUR	8 000
Assets in GBP (BB)	2200	Liabilities in GBP (BB)	1100
Assets in GBP (TB)	1100	Liabilities in GBP (TB)	0
		CET1 in EUR	4 200

The maximum open position in this new scenario is equal to EUR 1 126.83.

Computing the sensitivity above under this new scenario we get:

$$\text{Sensitivity} = -0.262\%$$

Institutions are required to report that sensitivity for the purpose of the ongoing monitoring (along with the sensitivity that is calculated using the internal methodologies).

#### **Example 7: Items at historical cost**

	Value in EUR		Value in EUR
Assets in EUR	10 000	Liabilities in EUR	8 000
Assets in GBP at historical cost	1 000		
		CET1 in EUR	3 000

The CET1 of the institution is not sensitive to changes in the FX rate (unless, for example, a big shock occurs and the item at historical cost is impaired). Accordingly, the maximum open position is:

$$\text{MaxOP} = 0$$

Accordingly, as outlined in the background section, these guidelines lay down a special treatment for items that are held at historical cost, i.e., if the item at historical cost is structural, then it can be exempted.

#### **Example 8: Calculation of own funds requirements before and after applying the waiver**

The parent institution, which reports in EUR, owns a subsidiary reporting in GBP. At the consolidated level, the institution reports in EUR. Furthermore, it is assumed that no items are deducted from

*CET1, that no trading book exists and that no own funds requirements exist for operational risk and CVA risk. The risk weights for credit risk are assumed to be 100% for all assets and the market risk RWAs are calculated using the standardised approach. Finally, it is assumed that the permission to offset the positions in the subsidiary and the parent bank in accordance with Article 325 has been granted.*

Parent institution at solo level reporting in EUR:

	Value in EUR		Value in EUR
Assets in EUR	700	Liabilities in EUR	625
Assets in GBP – participation	10		
		CET1 in EUR	85

Subsidiary at solo level reporting in GBP:

	Value in EUR		Value in EUR
Assets in GBP	300	Liabilities in GBP	225
		CET1 in GBP	75

Institution at consolidated level reporting in EUR:

	Value in EUR		Value in EUR
Assets in EUR	700	Liabilities in EUR	625
Assets in GBP	300	Liabilities in GBP	225
		CET1 in EUR	150

*If waivers are applied neither for the parent institution at solo level nor for the institution at the consolidated level, then the RWA figures and capital ratios are as follows:*

	Parent institution at solo level (without waiver)	Institution at consolidated level (without waiver)
Credit risk RWAs	710	1 000
FX risk - OFR	10	75
Total RWAs	720	1 075
CET1	85	150
<b>CET1 ratio</b>	<b>85/720 = 11.81%</b>	<b>150/1 075 = 13.95%</b>

*The maximum open position at consolidated level is equal to  $150/1\,000 \cdot 300 = 45$ .*

*If the institution has the permission in accordance with Article 352(2) for the solo level and for the consolidated level, then the RWA figures and capital ratios are as follows:*

	Parent institution at solo level (with waiver)	Institution at consolidated level (with waiver)
Credit risk RWA	710	1 000
FX risk RWA	0	30
Total RWA	710	1 030
CET1	85	150
<b>CET1 ratio</b>	<b>85/710 = 11.97%</b>	<b>150/1 030 = 14.56%</b>

**Example 9: Calculation of own funds requirements before and after applying the waiver of a perfectly hedged position at the consolidated level**

The underlying assumptions, as well as the positions, are the same as in Example 8. However, the institution decides to hedge the capital ratio at the consolidated level by entering into a short position at the parent institution. The institution has the permission to use positions in one institution or undertaking to offset positions in another institution or undertaking in accordance with Article 325 of the CRR.

Parent institution at solo level reporting in EUR:

	Value in EUR		Value in EUR
Assets in EUR	700	Liabilities in EUR	595
Assets in GBP – participation	10	Liabilities in GBP	30
		CET1 in EUR	85

Subsidiary at solo level reporting in GBP:

	Value in EUR		Value in EUR
Assets in GBP	300	Liabilities in GBP	225
		CET1 in GBP	75

Institution at consolidated level reporting in EUR:

	Value in EUR		Value in EUR
Assets in EUR	700	Liabilities in EUR	595
Assets in GBP	300	Liabilities in GBP	255
		CET1 in EUR	150

If waivers are applied neither for the parent institution at solo level nor for the institution at the consolidated level, then the RWA figures and capital ratios are as follows:

	Parent institution at solo level (without waiver)	Institution at consolidated level (without waiver)
Credit risk RWA	710	1 000
FX risk RWA	20	45
Total RWA	730	1 045
CET1	85	150
<b>CET1 ratio</b>	<b>85/730 = 11.64%</b>	<b>150/1 045 = 14.35%</b>

For the parent bank, at individual level the position in the foreign currency is a short position and no waiver can be applied. Thus, hedging the ratio at the consolidated level leads to higher own funds requirements at the solo level (compared with the previous example). The maximum open position at the consolidated level is equal to  $150/1\ 000 \cdot 300 = 45$ . If the institution has the permission in accordance with Article 352(2) for the consolidated level, then the RWA figures and capital ratios are as follows:

	Institution at consolidated level (with waiver)
Credit risk RWA	1 000
FX risk RWA	0
Total RWA	1 000
CET1	150
<b>CET1 ratio</b>	<b>150/1 000 = 15.00%</b>

#### **Example 10: step-by-step application of the guidelines**

The following example is meant to show in a simplified fashion how institutions and competent authorities are to apply the legal text of the guidelines. Consider an institution with the following simplified balance sheet:

##### Parent bank at solo level reporting in EUR:

	Value in EUR		Value in EUR
Assets in EUR (BB)	500	Liabilities in EUR (BB)	400
		Liabilities in USD (BB)	40
Assets in USD – participation (BB)	20	Liabilities in USD – T1 (BB)	10
Assets in GBP (BB)	30	Liabilities in SEK (BB)	10

		Liabilities in DKK (BB)	10
		CET1 in EUR (BB)	80

All items in the parent bank are banking book items. Items in EUR do not attract any FX risk at solo level.

*Subsidiary at solo level reporting in USD:*

	Value in EUR		Value in EUR
Assets in USD (BB)	300	Liabilities in USD (BB)	200
Assets in USD (TB)	100		
Assets in GBP (BB)	20		
Assets in DKK (BB)	30	Liabilities in DKK (BB)	10
		CET1 in USD	240

At subsidiary level, all items are banking book items, except for some items in the trading book in USD which value is EUR 100. Items in USD do not attract FX risk at solo level.

*Group at consolidated level reporting in EUR:*

	Value in EUR		Value in EUR
Assets in EUR (BB) – P	500	Liabilities in EUR (BB) – P	400
Assets in USD (BB) – S	300	Liabilities in USD (BB) – P	40
Assets in USD (TB) – S	100	Liabilities in USD – T1 (BB) – P	10
Assets in GBP (BB) – P	30	Liabilities in USD (BB) – S	200
Assets in GBP (BB) – S	20	Liabilities in SEK (BB) – P	10
Assets in DKK (BB) – S	30	Liabilities in DKK (BB) – P	10
		Liabilities in DKK (BB) – S	10
		CET in EUR	300

Items that are booked at parent bank level are flagged with a P, while those booked at subsidiary level are flagged with an S. The meaning of each colour is specified later in the example.

Section 4 of the guidelines (i.e. *overview of the requirements*) sets out a specific process that must be applied:

- (i) First, the procedural admissibility requirements in Section 5 and the substantive admissibility requirements in Section 6 need to be checked.
- (ii) If the application presented by the institution is compliant with the requirements in point (i), then the analysis of the competent authority should focus on the compliance of the application with Section 7 of the guidelines. Otherwise, the competent authority is expected to not grant the permission.
- (iii) If the application presented by the institution is compliant with the requirements in Section 7, then the position that can be excluded is determined in accordance with Section 8. Accordingly, positions that are analysed in Section 8 are those that meet all the requirements in the previous sections, i.e. that are assessed to be structural and taken for hedging the ratio.

In this example we assume that the institution consists of a parent bank and a subsidiary and that the permission referred to in Article 325 has not been granted, i.e. the positions in the parent bank and in the subsidiary cannot be offset. We assume that the institution applies the standardised approach for calculating its own funds requirements for market risk and that the institution requires the permission only at consolidated level since it aims to hedge only the consolidated ratio.

As mentioned in point (i), the first step of the approval encompasses the requirements set out in Sections 5 and 6 of the guidelines. With respect to Section 5, in light of the fact that the permission referred to in Article 325 has not been granted, the institution needs to specify how it computes the own funds requirements for FX risk and, assuming that an approval would be granted, how the structural FX position will be excluded from that net open position – the importance of this last step will be outlined at the end of this example. As mentioned in the background section, this requirement is meant to increase supervisory visibility on an aspect where there seems to be divergence in its application.

In the simplified balance sheet above, cells in red are representative of the positions for which the structural FX permission cannot be granted. Specifically:

- (i) the position in US dollars stems from the trading book and as such it does not meet the minimum requirement in Section 6.
- (ii) the position in SEK is short at group level and as such it does not meet the minimum requirement in Section 6.

Suppose now that the institution is requesting the structural FX permission for:

1. all its positions in USD, with the exception of the position that stems from the trading book;
2. all its positions in GBP
3. all its positions in DKK

All the positions for which it seeks the exemption stem from the banking book. In addition, the position for which the exemption is sought is long at consolidated level; indeed:

1. the position in USD for which the exemption is sought is net long:  $300 - 40 - 10 - 200 = 50$ ;
2. the position in GBP for which the exemption is sought is net long:  $20 + 30 = 50$ ;
3. the position in DKK for which the exemption is sought is net long:  $30 - 10 - 10 = 10$ .

As mentioned in the background section, the hedging effect of a position is the same regardless of whether the permission in Article 325 has been granted or not. That is why, for the purpose of Section 6 of the guidelines, whether a position is net long or net short has to be assessed considering all positions in the group (i.e. regardless of whether they are booked at parent bank level or at subsidiary level).

However, the requirements in Section 6 are more stringent where the permission is sought by an institution without the permission referred to in Article 325. Specifically, the requirement in paragraph 25 (and paragraph 26) applies to cases where the permission for which the exemption is sought is short at the level of the institution (or subset of institutions) constituting the group.

In the example, we are considering the case of an institution that does not have the permission referred to in Article 325. Therefore, it has to be checked whether the requirement in paragraph 25 is applicable or not:

1. For positions in GBP:
  - (i) the position for which the exemption is sought is net long at the level of the parent bank: 30;
  - (ii) the position for which the exemption is sought is net long at the level of the subsidiary: 20.

As a result, positions in GBP meet the conditions in Section 6, and paragraph 25 does not entail any other constraint.

2. For positions in USD:
  - (i) the position for which the exemption is sought is net short at the level of the parent bank:  $-40 - 10 = -50$ ;
  - (ii) the position for which the exemption is sought is net long at the level of the subsidiary:  $300 - 200 = 100$ .

Following paragraph 25 of the guidelines, this means that the positions in the parent bank can be further considered in the assessment of the application if they have been taken or are maintained with the sole purpose of hedging the consolidated ratio. As also mentioned in the background section, the term 'position' refers to the position in the foreign currency

and not to the items from which it stems. As a result, the competent authority should check that the position at the parent bank level (–50) is maintained with the sole purpose of hedging the ratio. For example, in this specific case, the institution may keep the position at parent bank level for the purpose of reducing the position stemming from the subsidiary, and it adjusts the short position booked by the parent bank depending on the value of the long position stemming from the subsidiary. Hence, the position at parent bank level could be considered to be taken with the sole purpose of hedging the ratio.

In addition, there should not be concerns from a prudential point of view related to the fact that the institution does not have the permission referred to in Article 325. Indeed, the subsidiary itself cannot incur losses due to changes in the USD/EUR exchange rate, i.e. there will not be any need for the parent bank to intervene to compensate somehow the losses of the subsidiary (a condition that is the basis of the approval of the permission in Article 325). In other words, the FX risk hedged by the short position stems from the translation of assets/liabilities of the subsidiary in the group's reporting currency following the consolidation process.

In this example we assume that the competent authority determines that the short position at parent bank level in USD has been taken/maintained with the sole purpose of hedging the ratio.

3. For positions in DKK:

- (i) the position for which the exemption is sought is net short at the level of the parent bank: –10;
- (ii) the position for which the exemption is sought is net long at the level of the subsidiary: 20.

Following paragraph 25 of the guidelines, it means that the positions in the parent bank can be further considered in the assessment of the application if they have been taken or are maintained with the sole purpose of hedging the ratio.

In this specific case, the institution could have reduced the position stemming from the subsidiary directly at the level of the subsidiary. For positions in USD (previous point), reducing the long position at the level of the subsidiary may not be trivial since that currency is the currency in which the greater part of the business is performed. For positions in DKK, however, it could be feasible. The competent authority should then deeply investigate whether the position at parent bank level has been taken for hedging the ratio or not.

In addition, the competent authority should consider that, in the case of an appreciation of DKK against USD and against EUR, a loss would occur at the level of the parent bank (since at that level the position in DKK is short); the gains at the level of the subsidiary (since at that level the position is long) may not be used to offset that loss since the permission in Article 325 has not been granted. This is different from the case presented for positions in



USD, where the position at parent bank level has been taken to cover only the translation risk arising from the consolidation process.

In this example, we assume that the competent authority determines that the position at parent bank level in DKK cannot be considered to be taken with the sole purpose of hedging the ratio.

As a result:

1. All positions in USD for which the exemption is sought meet the requirements in Section 6; hence, the competent authority should proceed to verify whether the institution meets the requirement in Section 7 for all those positions.
2. All positions in GBP for which the exemption is sought meet the requirements in Section 6; hence, the competent authority should proceed to verify whether the institution meets the requirement in Section 7 for all those positions.
3. With regard to the position in DKK, in principle the institution has a number of possibilities:
  - (i) the institution could request the permission only for the long position stemming from the subsidiary;
  - (ii) the institution does not proceed further with its intention of receiving the permission for its positions in DKK;
  - (iii) the institution could revise how the positions at parent bank level are managed to prove that they are maintained with the sole purpose of hedging the ratio.

In this example, we assume that the institution changes its application and requests the permission only for positions in DKK stemming from the subsidiary; of course, such a move may also trigger a rethinking of the strategy to hedge the ratio. The short position in DKK has been highlighted in violet to highlight that it has been excluded from the scope of the permission as part of this step.

The positions in DKK stemming from the subsidiary meets the requirements in Section 6. Hence, the competent authority should proceed in verifying whether the institution meets the requirement in Section 7 for those positions.

With regard to the requirements in Section 7:

- (i) paragraphs 27 and 28 are to assess the structural nature of the positions meeting the conditions in Section 6;
- (ii) paragraph 29 is to assess whether those positions are taken or maintained to hedge the ratio.

With respect to the structural nature, in the simplified balance sheet, items related to positions of type A for which the presumption of the structural nature has been recognised in the guidelines

are highlighted in green. All other positions (those highlighted in yellow or orange) are positions of type B.

For positions of type B an adequate justification of the structural nature is key for considering them to be of a structural nature. Here, we analyse some specific cases, which are to be treated as examples only; in particular, the conclusion of the assessment of the competent authority assumed below is not meant to provide any further guidance beyond what has been included in the guidelines. In other words, the conclusion of the competent authority has been included only for the purpose of showing how institutions are to apply the guidelines when the competent authority assesses some positions to be structural and others not.

In the example that we are analysing:

1. For positions of type B in USD, that justification could be based on the fact that they are managed with the sole purpose of hedging the ratio. For example, given this objective, the institution can prove its intention to roll out those positions as soon as they mature and to eventually adjust them to the extent needed to meet the objective in the risk management strategy. In this example, we assume that the competent authority determines that those positions are structural.
2. For positions of type B in GBP we differentiate between:
  - (i) positions of type B booked in the parent bank;
  - (ii) positions of type B stemming from the subsidiary.

We assume that positions of type B in the parent bank are items that the institution aims to keep in the long term (e.g. real estate not held at historical cost).

By contrast, we assume that positions of type B in the subsidiary stem from derivatives in the banking book. We assume that the positions in foreign currency related to those derivatives are unstable over time; in addition, the institution does not plan to roll out that FX position over time.

As a result, we assume that the competent authority determines that the positions booked in the parent bank are of a structural nature, while those stemming from the branch are not of a structural nature.

3. For positions of type B in DKK:

We assume that positions stemming from the subsidiary are related, for example to branches in Denmark, for which the institution can prove that there is a consolidated business whose size is stable over time. We assume that the competent authority has an overview of the business run by that subsidiary at an appropriate level of detail.

As a result, the competent authority determines that the positions stemming from the subsidiary are of a structural nature.

Items corresponding to positions of type B that have been recognised as structural following the assessment of the competent authority are highlighted in yellow; those that have not been recognised as such are highlighted in orange.

The competent authority should check that all requirements set out in paragraph 29 are met. While assessing those requirements, it is important also to cross-check, for example, that the justification provided for validating the structural nature of a position of type B is consistent with what is stated in the strategy itself.

For simplicity, we assume that those requirements are met for all three currencies.

Thus, Section 8 of the guidelines has to be applied in the context of the three currencies. As specified in Section 4, Section 8 will be applicable only for positions that have been found to be compliant with the requirements in the previous sections.

It is worth noting that the size of the structural net position must be determined regardless of the fact that the permission in Article 325 has been granted, i.e. all positions that are structural are to be net when applying Section 8.

Suppose that, following the calculation of the maximum open position in accordance with Section 8, the institution obtains the following result:

Currency	Size of the structural net position	Max net open position
USD	$300 - 40 - 10 - 200 = 50$	30
GBP	30	20
DKK	$30 - 10 = 20$	25

The values taken by the maximum net open position in the table are just assumptions. Several examples have already been included showing how the maximum open position has to be calculated. The values of the maximum net open position have been set to present how the guidelines apply both when such value is higher than the size of the structural position and when such value is lower.

In the context of USD, the maximum open position is lower than the size of the structural net position. As a result, when calculating the own funds requirements for FX risk, the institution should remove the effect of a net long structural position of size 30. This is achieved by removing all structural positions from the computation of the own funds requirements for FX risk, with the exception of a position of 20 (i.e. structural net position – maximum net open position =  $50 - 30$ ).

Since the permission in accordance with Article 325 has not been granted it is important also to identify where the position of 20 should be considered to stem from, i.e. from the parent bank or from the subsidiary. In this specific case, the position of 20 is considered to stem from the subsidiary, since there were no long positions at the parent bank level. As a result, the institution should compute the own funds requirements for FX risk considering:

- a long position in the subsidiary of 100 that is held in the trading book;
- a long position in the subsidiary of 20 that is structural, which, however, could not be removed because of the cap imposed by the maximum open position.

The computation of the own funds requirements for FX risk stemming from those positions must be done considering that positions stemming from the subsidiary and the parent bank cannot be netted. Deciding where the remaining structural position that has to be capitalised (20) stems from may not be trivial in some cases; indeed, the remaining position could be allocated to both the subsidiary and the parent bank (e.g. in the case where there are long structural positions at both levels). When the permission referred to in Article 325 has been granted, it is not relevant whether the remaining position is assumed to be in the parent bank or in the subsidiary, since the final own funds requirements will not change; however, where such permission has not been granted, then assuming it to be at the level of the parent bank or at the level of the subsidiary is actually relevant. That is why, when they do not have the permission in Article 325, institutions are required as per Section 5 of the guidelines to clarify how they actually exclude the structural positions if the permission is given.

In the context of GBP, the maximum open position is lower than the size of the structural net position. The structural position stems only from the parent bank. Accordingly, the institution should apply Article 352(1) as if only a position of 10 (i.e. structural net position – maximum net open position = 30 – 20) actually stems from the parent bank, along with the position of 20 stemming from the subsidiary that was assessed to be non-structural.

In the context of DKK, the maximum open position is greater than the structural net position; as a result, all positions in DKK stemming from the subsidiary can be excluded when computing the own funds requirements for FX risk. However, the institution still needs to capitalise the short position at the parent bank level. It should be noted that, in cases of under-hedges (i.e. the maximum open position is greater than the structural net position), it is not relevant to identify where the remaining structural position to be capitalised has to be 'allocated', since there is no structural position that exceeds the maximum open position.