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Final draft Regulatory Technical Standards

on the treatment of non-trading book positions subject to foreign exchange risk or commodity risk under Articles 325(9), 325bf(9) and 325bg(4) of Regulation (EU) No 575/2013 (revised Capital Requirements Regulation – CRR2)

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1. Executive summary

Regulation (EU) No 575/2013 (the revised Capital Requirements Regulation – CRR2) implements in EU legislation, inter alia, revised requirements to compute own funds requirements for market risk. In accordance with that Regulation, institutions are required to calculate own funds requirements for market risk for:

- positions held in the trading book;
- positions held in the banking book (i.e. non-trading book) bearing foreign exchange (FX) or commodity risk.

In line with Article 325(9), the EBA is mandated to develop draft regulatory technical standards (RTS) to specify how institutions should calculate the own funds requirements for non-trading book positions that are subject to FX risk or commodity risk in accordance with the alternative standardised approach (SA) and the alternative internal model approach (IMA).

The final draft RTS specify that institutions can use either the last available accounting value or the last available fair value as a basis for calculating the own funds requirements for non-trading book positions subject to FX risk. Although institutions are not expected to perform a full revaluation of non-trading book positions attracting FX risk, the draft RTS require them to update the FX component of those positions. The frequency at which such updates must be performed is monthly for institutions using the SA for capitalising the FX risk stemming from the banking book and daily for those using the IMA.

The draft RTS also set out the treatment for non-monetary items held at historical cost that may be impaired due to changes in the relevant exchange rate. In this respect, the draft RTS identify a specific methodology that institutions should use when capitalising the FX risk stemming from those items under the alternative SA, while they require institutions to directly model the risk of an impairment due to changes in the relevant exchange rate when they capitalise the FX risk of those positions using the alternative IMA.

As regards non-trading book positions attracting commodity risk, the draft RTS set out that institutions are to use the last available fair value when computing the corresponding own funds requirements. The draft RTS specify that the fair value must be updated monthly where the own funds requirements for those positions are calculated using the alternative SA and daily where they are calculated using the alternative IMA.

Articles 325bf(4) and 325bg(9) mandate the EBA to draft RTS to specify how institutions are to calculate changes in hypothetical profit and loss (HPL), actual profit and loss (APL) and risk theoretical profit and loss (RTPL) for the purpose of the backtesting and profit and loss (P&L) attribution requirements. Considering that for non-trading book positions some specifications are needed to ensure a meaningful implementation of those requirements, these draft RTS also include provisions about the calculation of the HPL and APL for non-trading book positions. Specifically, for positions that are subject to FX risk or to commodity risk, the draft RTS generally expect institutions not to include in the effects of APL and HPL changes that are not related to FX risk or commodity risk and that may lead, for example, to overshootings when comparing those changes against the Value-at-Risk numbers. However, the draft RTS also foresee specific treatments that reduce the operational burden that institutions may be subject to if they were to isolate those components under all circumstances.

These draft RTS have been finalised considering the comments received in response to the Consultation Paper, which put forward a first proposal with respect to these RTS. With the exception of the treatment set out for capitalising non-monetary items at historical cost, the comments were broadly supportive of the approach set out by the EBA. However, a number of technical suggestions were also put forward, which were considered during the finalisation and included where relevant.

2. Background and rationale

Regulation (EU) No 575/2013 (the revised Capital Requirements Regulation – CRR2) implements in EU legislation, inter alia, the revised requirements to compute own funds requirements for market risk. In accordance with that Regulation, institutions are required to calculate own funds requirements for market risk for:

- positions held in the trading book;
- positions held in the banking book (i.e. non-trading book) bearing foreign exchange (FX) or commodity risk.

In Article 325(9), the EBA is mandated to develop draft regulatory technical standards (RTS) to specify how institutions should calculate the own funds requirements for non-trading book positions that are subject to FX risk or commodity risk in accordance with the alternative standardised approach (SA) and the alternative internal model approach (IMA). In addition, Articles 325bf(4) and 325bg(9) mandate the EBA to draft RTS to specify how institutions are to calculate the changes in hypothetical profit and loss (HPL), actual profit and loss (APL) and risk theoretical profit and loss (RTPL) for the purpose of the backtesting and P&L attribution requirements.

2.1 Valuation of non-trading book positions attracting foreign exchange risk for the purpose of the standardised approach

Article 325q of CRR2 defines the risk factors for FX risk for the SA, while Article 325r(5) outlines how institutions should calculate the delta FX risk. Accordingly, CRR2 already sets out all key aspects that institutions should follow for the purpose of computing the own funds requirements for FX risk and commodity risk using the SA.

Article 105 requires institutions to revalue trading book positions at fair value on at least a daily basis. However, it does not set any specific requirements with respect to the valuation of banking book positions in the context of the calculation of the own funds requirements for market risk associated with those positions.

Accordingly, the EBA deems it necessary to define values of non-trading book positions that institutions are to use when calculating, for example, the own funds requirements for FX risk.

Positions in the banking book are most often not fair valued. However, institutions may, for disclosure purposes – depending on the accounting standards implemented in the institution's jurisdiction – fair value all banking positions, e.g. on a quarterly basis.

In the Consultation Paper on which these final draft RTS are based, the EBA acknowledged that requiring a fair valuation of all banking book positions just for the purpose of computing the own funds requirements for market risk would be overly burdensome compared with the benefits that may come from such requirements. All respondents agreed with this analysis. As a result, the EBA decided to retain the treatment envisaged for consultation and the final draft RTS set out the following.

- Institutions should use the accounting value of banking book positions as a basis for calculating the relevant risk measures that are needed to obtain the own funds requirements for market risk. In other words, the accounting value should be considered to represent the market value for the purpose of Article 325r(5).
- Institutions that are fair valuing all banking book positions on at least a quarterly basis may use the fair value instead of the accounting value as a basis for computing the own funds requirements for market risk.

Accordingly, institutions should consider the same value for a non-trading book position as a basis for computing the own funds requirements within, for example, a quarter (i.e. until the non-trading book position is fully revalued). However, in line with international standards, institutions should be required to update the FX components of non-trading book positions. Specifically, in line with the Fundamental Review of the Trading Book (FRTB) standards, in which institutions are required to compute the own funds requirements for market risk in accordance with the SA on a monthly basis, the draft RTS require institutions to update the FX component of a non-trading book position on at least a monthly basis.

In general, the EBA expects the risk management of the FX risk stemming from banking book positions to be performed consistently using the value that is chosen for computing the own funds requirements; for example, if the institution calculates the own funds requirements for FX risk using the accounting value as a basis, then the risk management should also be performed on that basis.

It should be noted that, regardless of whether the institution uses the fair value or the accounting value, it must be able to identify the FX component in the value; that is, the institution must be able to explicitly express the pricing function used to determine the accounting value (or the fair value) with respect to the relevant exchange rate, and accordingly calculate, for example, the delta risk in a meaningful way.

Example:

The institution computed the fair value of a loan on a given date for disclosure purposes. The fair value of the loan on the given date was USD 110, while the FX rate was USD 1 = EUR 0.9. Accordingly, when computing the delta sensitivity, in accordance with Article 325r(5):

*V(FX) = 110 * FX = 110 * 0.9 = EUR 99*

*Delta = (V(FX * 1.01) – V(FX))/0.01 = (110 * 0.9 * 1.01 – 110 * 0.9)/0.01 = EUR 99*

The day after the fair valuation, the loan itself is not fully fair valued. However, the FX rate has changed from USD 1 = EUR 0.9 to USD 1 = EUR 0.8. Accordingly, when computing the delta sensitivity the day *after the fair valuation, the institution should keep the value as it was at the fair valuation date in the reporting currency and update the FX component:*

*V(FX) = 110 * FX = 110 * 0.8 = EUR 88*

Delta = EUR 88

Non-monetary items at historical cost

An institution may have in its balance sheet non-monetary items that are held at historical cost that may be impaired due to sharp movements in the exchange rate.

In general, non-monetary items that are booked at historical cost keep the same balance sheet value regardless of movements in the exchange rates. However, in case of indication of an impairment (due to a sharp move in the FX rate and/or other circumstances) the carrying amount of an asset is the lower of its carrying amount before considering possible impairment losses (using the FX rate on the date of the transaction) and its recoverable amount (using the FX rate on the reporting date). Thus, in certain instances a movement in the FX rate may also lead to FX-related losses with respect to non-monetary items that are booked at historical cost.

Considering that the institution may suffer losses due to the FX risk embedded in those items, such risk has to be capitalised. In this context, the EBA acknowledges that the sensitivity-based method may not be fit for the purpose of calculating the own funds requirements for FX risk stemming from non-monetary items that are held at historical cost. However, the EBA believes that it is important that the FX risk of those items is captured under the Pillar 1 requirements in the same way by all institutions in the Union, and accordingly provides for a specific treatment in these draft RTS.

Given a non-monetary item at historical cost, where the institution is applying the requirements in the CRR on a solo basis, it is required to:

1. identify the foreign currency for which depreciation against the reporting currency would lead to the highest impairment of the item;
2. treat that item as linearly dependent on the FX rate (i.e. delta-1 product).

The identification of the foreign currency in accordance with point 1 is needed since, without further specification, institutions may interpret the term ‘currency of denomination’ referred to Article 325q in different ways, possibly leading some institutions to capitalise the FX risk in those items and others not to.

In general, the treatment envisaged at the solo level is also applicable at the consolidated level. However, there is one case for which the EBA decided to include a specific provision to ease the application of the framework. Specifically, the draft RTS clarify that where the non-monetary item held at historical cost stems from a subsidiary, and the reporting currency of the subsidiary is different from the reporting currency of the parent bank, the non-monetary item must be treated as denominated in the currency of the subsidiary.

Example:

One institution reporting in euro has a subsidiary in the United States, of which the functional currency is the US dollar. The subsidiary in the United States has a building held at cost in the UK.

Assets	Value in EUR	Liabilities	Value in EUR
Loans in EUR	100	Deposits in EUR	140
Loans in USD	50		
Real estate in the UK stemming from the subsidiary in the US	30	CET1	40

In principle, the real estate item may be impaired due to changes in the GBP/USD exchange rate. Accordingly, it could be argued that the institution at the consolidated level should consider both the EUR/USD and the EUR/GBP exchange rates when computing the own funds requirements for FX risk for that item. However, for simplicity, and acknowledging that the sensitivity-based method is not designed to capture the FX risk stemming from those items, the draft RTS clarify that the item should be treated as an item in US dollars (i.e. the reporting currency of the subsidiary from which it stems) when computing the own funds requirements for FX risk at the consolidated level.

All respondents to the Consultation Paper were critical of the proposed treatment. In particular, a clear preference for a Pillar 2 requirement treatment was highlighted.

It should be noted that these RTS are relevant in the context of the alternative SA, which is in place only for reporting purposes. The alternative SA, as currently framed in CRR2, does not foresee any treatment for structural FX positions, i.e. CRR2 does not allow banks to exclude any FX position from the calculation of own funds requirements (for reporting purposes) under the alternative SA.

When it comes to the current SA, which is used for capital purposes, the EBA has addressed the concerns from respondents in the guidelines on structural FX[1]. Specifically, the structural FX guidelines clarify the following points.

- At the solo level, the competent authorities are expected to recognise as structural the investments in subsidiaries. Those items are in general kept at historical cost.
- Non-monetary items at historical cost are not subject to the cap imposed by the maximum open position, as defined in these guidelines.

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

Thus, for capital purposes, investments in subsidiaries are expected to be waived as part of the structural FX provision, and the corresponding FX risk to not be capitalised as part of the Pillar 1 requirements under that scenario. However, the exclusion is the result of the assessment performed by the competent authority, which is expected, for example, to check that the item is actually structural (e.g. that the institution does not intend to sell the subsidiary in accordance with its business strategy). The EBA deems such supervisory assessment warranted.

Considering that:

(i) the EBA expects CRR3 to finally include the possibility for banks to remove structural positions from the scope of positions subject to FX risk; and

(ii) the EBA expects that the above-mentioned favourable treatment for investment in subsidiaries under the structural FX provision will also be kept under EU implementation of the FRTB SA;

the EBA decided to keep the treatment proposed for consultation.

2.2 Valuation of non-trading book positions attracting commodity risk for the purpose of the standardised approach

With respect to the valuation of banking book instruments that are attracting commodity risk, the draft RTS propose that institutions should take the last available fair value as a basis for computing the own funds requirements for market risk. Institutions are required to fair value those positions on at least a monthly basis.

2.3 Valuation of non-trading book positions attracting foreign exchange or commodity risk under the internal model approach

Considering that the SA is also designed to represent a fallback for desks moving from the IMA to the SA (e.g. because of not meeting the backtesting requirements), it is desirable to have common provisions with respect to the valuation of non-trading book positions bearing FX risk and commodity risk. Accordingly, the EBA proposes in these draft RTS a framework for the IMA that is broadly in line with the one envisaged for the SA.

Valuation of non-trading book positions subject to foreign exchange risk (and not to commodity risk)

Specifically with regard to FX risk, institutions should be allowed to use either the last available accounting value or the fair value as a starting point for calculating the own funds requirements for FX risk.

However, the draft RTS specify that the last available value should be updated daily to reflect changes in the FX risk factors. The updated value should then be considered as the basis for computing the expected shortfall measure or the stress scenario risk measure. The draft RTS specify that risk factors that do not reflect FX risk or commodity risk cannot be shocked when calculating the expected shortfall measure or the stress scenario risk measure.

Example:

The institution has in its banking book a financial instrument held at cost. The last time the institution calculated its accounting value was at the end of Q2 2020 (i.e. 30 June 2020). That value is expressed in the risk-measurement model as a function of three risk factors.

Value of the instrument = V (x1, x2, x3)

Suppose that only x1 is an FX risk factor. If the institution was to calculate the expected shortfall measure on 10 July 2020, then the draft RTS clarify that it should first take the last available accounting value and update x1 to reflect the value of x1 on the 10 July 2020. This can be represented by the following formula:

V_basis (t2) = V (x1(t2), x2(t1), x3(t1))

where t1 = 30 June 2020 and t2 = 10 July 2020

As a result, the institution will calculate the expected shortfall measure (shocking x1, assuming it to be modellable) by computing the value of the instrument following the shock:

V_shocked (t2) = V (x1(t2) + shock, x2(t1), x3(t1))

As mentioned, the draft RTS clarify that x2 and x3 cannot be shocked where the institution computes the expected shortfall measure.

As explained later, when it comes to positions that are subject to FX risk and not subject to commodity risk, institutions are required to calculate the HPL and APL related to non-trading book positions for the purpose of the backtesting and profit and loss attribution requirements, reflecting changes only in the FX component. This requirement is consistent with the way institutions are to obtain the basis for computing the own funds requirements, as explained above (in the example, by updating the FX component of the last available accounting or fair value), and with the way they compute the expected shortfall and the stress scenario risk measure (in the example, by shocking only x1).

However, as detailed later in this background section, for some positions that are subject to FX risk (and not to commodity risk), institutions may decide to reflect in the HPL and APL changes the changes related to all components determining the value of a non-trading book position. Where an institution decides to do so, when determining the basis for calculating the own funds requirements, it must update all risk factors determining the value of the financial instrument, i.e. following the notation of the example *V_basis (t2) = V (x1(t2), x2(t2), x3(t2))*. It should also be stressed that, in this case, shocks are applied only to x1 for the purpose of computing the expected shortfall measure or the stress scenario risk measure, i.e. only to risk factors that reflect FX risk.

Valuation of non-trading book positions subject to commodity risk (and not to FX risk)

As regards positions attracting commodity risk, in line with the framework proposed under the SA, institutions are required to fair value those positions and use the fair value as a basis for computing the own funds requirements. However, institutions using the IMA are required to perform this full revaluation on a daily basis.

In relation to these instruments, the draft RTS clarify that institutions are to shock only risk factors related to commodity risk when computing the expected shortfall measure or the stress scenario risk measure.

Valuation of non-trading book positions subject to both commodity risk and FX risk

Positions that are subject to both FX and commodity risk are to be treated as positions subject to commodity risk when it comes to their valuation. Indeed, they should fulfil both the requirements applicable to positions subject to FX risk and the requirements for positions subject to commodity risk. In this context, it is easy to see the following:

- The requirements for positions attracting commodity risk are stricter than those applicable to positions subject to FX risk; indeed, for positions attracting commodity risk, institutions should perform a daily full fair valuation.

- The requirements for positions attracting commodity risk are not in conflict with those applicable to positions subject to FX risk, i.e. the institution can apply the requirements applicable to one risk class without going against the requirements in place for the other risk class.

As a result, positions attracting both commodity and FX risk should also be fair valued on a daily basis. In addition, when computing the expected shortfall or the stress scenario risk measure, institutions should shock only FX and commodity risk factors.

Specification of the HPL and APL for banking book positions subject to FX risk (and not commodity risk)

As specified, the proposed draft RTS do not require a daily fair valuation of the instruments in the non-trading book bearing FX risk and not commodity risk. Instead, for items with FX risk but not commodity risk, only a daily update of the FX component is required.

Accordingly, for example, an institution that is fair valuing its banking book positions on a quarterly basis will observe bumps in the value of its portfolio at the fair-valuing date that are not triggered by FX risk factors.

It appears that specific definitions of HPL and APL in the portfolio's value are needed to address the problem of having bumps that may lead to overshooting in the backtesting, although this is not due to changes in the FX risk component of the price. Accordingly, these draft RTS set out that, if at time t the institution is fully revaluing its banking book positions, when calculating the APL and HPL as $V_t - V_{t-1}$ for the purpose of backtesting VaR_{t-1}, the value of the portfolio in t, V_t, must be calculated ignoring that at time t a full revaluation of the banking book positions has been performed. Accordingly, when calculating V_t the institution should take the last available value of the banking book positions (before time t) as a basis and update the FX component with the FX rate at time t. In this way, the base value over which the FX component is updated will be the same, and any overshooting will be due only to changes in the FX risk component.

The treatment described above for APL and HPL solves the distortion of the PLA test through bumps in the HPL, as the RTPL – due to its calculation in the value-at-risk engine –reflects only changes in the FX component of banking book positions. In this way, the same definition of HPL would be used in the context of the PLA and in the context of the backtesting. In general, respondents to the consultation paper agreed with the definitions proposed above for HPL and APL for non-trading book positions attracting FX risk. However, it was also noted that for institutions it may be operationally challenging to capture only the changes in the FX components when computing the HPL and APL; on that basis, it was proposed that the operational issue be addressed by allowing institutions to use a sensitivity-based P&L to obtain the hypothetical and actual changes in the portfolio's value. Following such feedback, the EBA decided to amend the draft RTS proposed for consultation introducing this framework.

1. In general, institutions are to calculate the HPL and APL related to non-trading book positions reflecting only changes in the FX components of a non-trading book position.

2. For non-trading book positions, the value of which does not change linearly with changes in the relevant exchange rate, the institution may calculate the HPL and APL by reflecting the changes in all the components determining the value of the non-trading book positions. Where the institution decides to use such possibility, it should do so for all non-trading book positions included in the trading desk, the value of which is non-linear in the FX component.

The possibility of reflecting changes in all components used for calculating the value of a non-trading book position is limited to non-linear positions in the FX component, since for those that are linear a full revaluation-based P&L coincides with a sensitivity-based P&L. Thus, fulfilling the requirements as presented for consultation should not pose operational issues to institutions.

Finally, it should be noted that reflecting changes in all components for the purpose of computing the HPL and APL actually means fully revaluing the non-trading book position on a daily basis. Thus, as anticipated in the previous section, for those positions for which the institution reflects all changes in the APL and HPL, the institution is required to update not just the FX risk factors from the last available value to obtain the value that is used as a basis for computing the own funds requirements but all risk factors on a daily basis.

Considering that there may be positions that are subject to both commodity risk and FX risk, the final draft RTS make explicit that the provisions set out in this section are relevant only for positions that are subject to FX risk and not commodity risk. The case of a position subject to both risks is captured in the following section.

Specification of the HPL and APL for banking book positions subject to commodity risk

A position attracting commodity risk can be a position directly in a commodity itself or a derivative on a commodity.

Without considering any potential FX risk, a position in the commodity itself is subject only to commodity risk factors, namely the price of the commodity. Thus, the HPL and APL are to be calculated by assessing the variation in the price of the commodity.

Derivatives on commodities held in the non-trading book may also depend on other risk factors, e.g. interest rates. In principle, the EBA could ask institutions to calculate the HPL and APL stemming from those derivatives by reflecting changes in commodity risk factors only. However, considering that positions in derivatives on commodities in the non-trading book are expected to be non-material, institutions are not required to isolate the commodity risk component when computing the actual and hypothetical changes. However, the possibility of reflecting in the APL and HPL only the commodity risk component (and the FX risk component where the position is subject to both risks) is kept in the final draft RTS to ensure that institutions can obtain the actual and hypothetical changes solely on the basis of risks that are captured in the risk-measurement model

The requirements set out in the previous paragraph are applicable to any position subject to commodity risk, i.e. also to those positions subject to commodity and FX risks.

Some useful clarifications

The provisions outlining the calculation of the hypothetical and actual changes in the portfolio's value for positions attracting FX risk but not commodity risk have been included in these draft RTS as a derogation to the RTS on the backtesting and profit and loss attribution requirements, in order to cluster aspects relating to non-trading book positions subject to FX risk and commodity risk in one set of RTS. It should, however, be noted that, unless otherwise specified in these draft RTS, all requirements included in the RTS on the backtesting and profit and loss attribution requirements also hold for non-trading book positions. For example, around the calculation of the RTPL, these draft RTS do not amend those on the profit and loss attribution requirements; thus, also for non-trading book positions, institutions are required to calculate the RTPL by reflecting only changes in risk factors to which they apply scenarios of future shocks when calculating the expected shortfall measure or the stress scenario risk measure.

Another point that is worth clarifying relates to the scope of application of the RTS. As mentioned earlier, the framework set out for institutions using the IMA to capitalise the foreign exchange risk stemming from non-trading book positions is in line with the framework for institutions using the SA. Fundamentally, the main difference relates to the frequency of updating of the foreign exchange risk component, which has been set to daily in the IMA and monthly in the SA. The same holds for commodity risk, where institutions are required to fully revalue the position attracting commodity risk on a daily or monthly basis depending on whether they use the SA or the IMA.

If a trading desk is in the IMA scope, but for one quarter it does not meet, for example, the backtesting requirements, then its positions are to be capitalised using the SA. Thus, in principle, the foreign exchange component of the non-trading book positions in those desks could be updated on a monthly basis in the quarter when they are capitalised using the SA. However, to meet the backtesting and profit and loss attribution requirements in the following quarter, the institution needs the time series of APL, HPL and RTPL over the past 250 business days – those changes can be built only by updating the foreign exchange risk factor on a daily basis. Thus, in practice, whenever a desk is in the IMA scope, regardless of whether its positions are actually capitalised using the IMA, the institution needs to update the value of a non-trading book position in the desk on a daily basis; in other words, the requirements set out in section 2 of the draft RTS (see legal text) are actually applicable to all positions in trading desks that are in the IMA scope. The same kind of reasoning can be reiterated for positions attracting commodity risk; thus, in practice, institutions are required to fully revalue the positions attracting commodity risk on a daily basis when they are held in desks that are in the IMA scope.

Non-monetary items at historical cost

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

On this basis, the draft RTS specify that, where institutions opt to capitalise the FX risk stemming from non-monetary items at historical cost using the IMA (pending permission of the competent authority), they should do so by modelling the risk that such items would be impaired due to changes in the relevant exchange rates.

3. Draft regulatory technical standards on the treatment of non-trading book positions subject to foreign exchange risk or commodity risk under Articles 325(9), 325bf(9) and 325bg(4) of Regulation (EU) No 575/2013

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supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards on the calculation of the own funds requirements for market risk for non-trading book positions subject to foreign exchange risk or commodity risk with the approaches set out in points (a) and (b) of Article 325(3) of Regulation (EU) No 575/2013 and their treatment under Articles 325bf and 325bg

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Regulation (EU) No 575/2013 of 26 June 2013 of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 [2], and in particular the third subparagraph of Article 325(9), the third subparagraph of Article 325bf(9) and the third subparagraph of Article 325bg(4) thereof,

Whereas:

(1) In the context of the alternative standardised approach, institutions compute the own funds requirements for market risk stemming from non-trading book positions on the basis of the value taken by such non-trading book positions. Given that there are different ways for valuing non-trading book positions, this regulation should specify whether institutions should use the accounting or the fair value.

(2) Under the alternative standardised approach, own funds requirements for foreign exchange risk for non-trading book positions should be calculated considering the non-trading nature of the items from which those positions stem. Institutions should not be required to perform a daily valuation for non-trading book positions since the value of those positions is not only driven by market risk factors. Instead, institutions should, in general, be required to reflect only those changes that are associated with the foreign exchange risk components of non-trading book positions.

(3) In order to limit the operational burden in implementing these standards, institutions should use the most recent accounting value of a non-trading book position as a basis for the purpose of computing the own funds requirement for foreign exchange risk in accordance with the alternative standardised approach. However, institutions should be allowed to use the fair value instead of the accounting value if the fair value of all non-trading book positions is calculated at least quarterly, since the fair value is deemed an appropriate basis for the calculation.

(4) The frequency at which institutions should be requested to update the basis used to reflect the changes in the foreign exchange risk factors should be monthly because such frequency would limit any potential misrepresentation of the foreign exchange risk in the non-trading book. At the same time, that frequency is proportionate, in particular compared to the frequency at which institutions are required to update the foreign exchange risk factors under the alternative model approach in accordance with this Regulation.

(5) Considering the specificities characterising foreign exchange positions stemming from non-monetary items whose value is not updated at each reporting date to reflect changes in the exchange rate, a specific treatment should be laid down in this regulation to

[2] OJ, L176, 27.6.2013, p. 1.

harmonise practises where calculating the own funds requirements for foreign exchange risk for those items in accordance with the sensitivity-based method referred to in part 3, title IV, Chapter 1a, section 2 of Regulation (EU) No 575/2013.

(6) In line with the international accounting standards, institutions are in general required to fair value financial instruments bearing commodity risk. Also in cases where an institution physically holds a commodity and does not use the fair value of that position for accounting purposes, the fair value of that position should be used, however, as a basis for computing the own funds requirements, since it ensures an accurate and simple implementation of the alternative standardised approach. In addition, using the fair value as a basis allows institutions to accurately recognise hedges and diversification effects between positions that are held in the non-trading book and those held in the trading book. That basis should be updated monthly, since the same considerations as for the update of the basis for computing the own funds requirements for foreign exchange risk apply.

(7) The overarching regulatory framework setting out the requirements on the valuation of positions in the non-trading book subject to foreign exchange or commodity risk under the alternative internal model approach should be aligned to the one envisaged under the standardised approach, considering that there may be trading desks the positions of which are capitalised using the alternative standardised approach in one quarter and the alternative internal model approach in another. However, this Regulation should reflect that, differently from the alternative standardised approach, the alternative internal model approach requires the computation of daily figures.

(8) For the purposes of the back-testing and the profit and loss attribution requirement as set out in Articles 325bf and 325bg of Regulation (EU) No 575/2013 under the alternative internal model approach, this regulation should also specify how institutions have to calculate actual and hypothetical changes specifically in relation to the value of their non-trading book positions. To this end, it is necessary to establish special provisions with regards to Commission Delegated Regulation (EU) (…/…) of xxx on back-testing and profit and loss attribution requirements under Articles 325bf and 325bg of Regulation (EU) No 575/2013[3] in order to address specific characteristics of non-trading book positions subject to foreign exchange risk or commodity risk. In general, the actual and hypothetical changes should only reflect those changes related to market risk factors in order to ensure consistency with the scope of risks captured in the risk-measurement model. However, for non-trading book positions subject to commodity risk and non-trading book positions that do not change linearly with movements in the exchange rate, this Regulation should also allow institutions to reflect in the actual and hypothetical changes the changes related to all components determining the value of a non-trading book position, in order to take duly into account that it may be challenging to isolate changes related to foreign exchange and commodity risk.

(9) The provisions in this Regulation are closely linked, since they all deal with the treatment of non-trading book positions that are subject to foreign exchange risk or commodity risk. To ensure coherence between those provisions, which should enter into force at the same time, and to facilitate a comprehensive view and compact access to them by persons subject to those obligations, it is desirable to include all the

[3] OJ reference to be inserted once available

regulatory technical standards required by Regulation (EU) No 575/2013 on this topic in a single Regulation.

(10) This Regulation is based on the draft regulatory technical standards submitted by the European Supervisory Authority (European Banking Authority) (EBA) to the Commission.

(11) EBA has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093/2010[4],

HAS ADOPTED THIS REGULATION:

SECTION 1

CALCULATION OF THE OWN FUNDS REQUIREMENTS FOR MARKET RISK FOR NON-TRADING BOOK POSITIONS THAT ARE SUBJECT TO FOREIGN EXCHANGE RISK OR COMMODITY RISK IN ACCORDANCE WITH THE ALTERNATIVE STANDARDISED APPROACH UNDER POINT (a) OF ARTICLE 325(3) OF REGULATION (EU) No 575/2013

Article 1

Calculation of the own funds requirements for non-trading book positions subject to foreign exchange risk

1. Where calculating the own funds requirement for non-trading book positions subject to foreign exchange risk under the sensitivities-based method in accordance with section 2 of part 3, title IV, Chapter 1a of Regulation (EU) No 575/2013, institutions shall use the last available accounting value of a non-trading book position that is subject to foreign exchange risk as a basis.

2. By way of derogation from paragraph 1, institutions may use the last available fair value of a non-trading book position that is subject to foreign exchange risk, provided that the fair value of all non-trading book positions is calculated at least on a quarterly basis. Where institutions apply this paragraph, they shall apply it consistently to all non-trading book positions subject to foreign exchange risk.

3. Institutions shall update the last available value that is used as a basis for computing the own funds for foreign exchange risk in accordance with paragraphs 1 and 2 at least on a monthly basis in order to reflect changes in the value of the foreign exchange risk factors.

[4] 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, 15.12.2020, p. 12).

4. Where an item meets all of the following conditions:

(a) it is not measured at fair value,
(b) it is subject to the risk of impairment due to foreign exchange risk, and
(c) its accounting value is not updated at each reporting date to reflect the changes in the exchange rate between the foreign currency and the reporting currency,

institutions shall identify the currency of denomination of the item as the foreign currency whose depreciation against its reporting currency would lead to the highest impairment of the item.

Where an institution computes the own funds requirements of Regulation (EU) No 575/2013 for market risk on a consolidated basis, the currency of denomination of an item shall be identified as the reporting currency of the institution which recognises that item in its individual financial statement, where all of the following conditions are met:

(a) the item is not measured at fair value,
(b) the item is subject to the risk of impairment due to foreign exchange risk,
(c) the institution's reporting currency differs from the reporting currency of the institution that recognises the item in its individual financial statement,
(d) the item's accounting value is not updated at each reporting date to reflect the changes in the exchange rate between the foreign currency and the reporting currency of the institution recognising the item in its individual financial statement.

5. The value of the sensitivity calculated in accordance with Article 325r(5) of Regulation (EU) No 575/2013 corresponding to the items referred to in paragraph 4 shall be equal to the value which those items have in the currency of denomination identified in accordance with paragraph 4 multiplied by the spot exchange rates between the currency of denomination and the institution's reporting currency.

Article 2

Calculation of the own funds requirements for non-trading book positions subject to commodity risk

Where calculating the own funds requirement for non-trading book positions subject to commodity risk under the sensitivities-based method in accordance with section 2 of part 3, title IV, Chapter 1a of Regulation (EU) No 575/2013, institutions shall use the latest available fair value of those positions as a basis. Institutions shall fair value those positions at least on a monthly basis.

SECTION 2

CALCULATION OF THE OWN FUNDS REQUIREMENTS FOR MARKET RISK FOR NON-TRADING BOOK POSITIONS THAT ARE SUBJECT TO FOREIGN EXCHANGE RISK OR COMMODITY RISK IN ACCORDANCE WITH THE ALTERNATIVE INTERNAL MODEL APPROACH UNDER POINT (b) OF ARTICLE 325(3) OF REGULATION (EU) No 575/2013

Article 3

Calculation of the own funds requirements for non-trading book positions subject to foreign exchange risk and not to commodity risk

1. Where calculating the own funds requirements for non-trading book positions subject to foreign exchange risk and not to commodity risk assigned to trading desks in accordance with the alternative internal model approach as set out in Chapter 1b of part 3, title IV of Regulation (EU) No 575/2013, institutions shall use the last available accounting value of a non-trading book position that is subject to foreign exchange risk as a basis.

2. By way of derogation from paragraph 1, institutions may use the last available fair value of a non-trading book position as referred to in paragraph 1as a basis for calculating the own funds requirements, provided that the fair value of all non-trading book positions is calculated at least on a quarterly basis. Where institutions apply this paragraph, they shall apply it consistently to all non-trading book positions referred to in paragraph 1.

3. Institutions shall update the last available value that is used as a basis for computing the own funds for foreign exchange risk in accordance with paragraphs 1 and 2 on a daily basis in order to reflect changes in the value of the foreign exchange risk factors.

4. By way of derogation from paragraph 3, when updating the last available value of a non-trading book position on a daily basis, institutions shall reflect changes in the value of all risk factors for a position for which they used the derogation referred to in Article 5(2).

5. For the purposes of calculating the expected shortfall risk measure referred to in Article 325bb of Regulation (EU) No 575/2013 and the stress scenario risk measure referred to in Article 325bk of that Regulation in relation to non-trading book positions subject to foreign exchange risk and not to commodity risk, institutions shall apply scenarios of future shock only to risk factors that belong to the foreign exchange broad risk factor category.

6. Institutions shall capture in their risk-measurement model the risk of impairment due to changes in the relevant exchange rates posed by items that are subject to that risk, where those items are not measured at fair value and their accounting values are not updated at each reporting date to reflect the changes in the exchange rate between the foreign currency and the reporting currency of the institution recognising the item in its individual financial statement.

Article 4

Calculation of the own funds requirements for non-trading book positions subject to commodity risk

1. Where calculating the own funds requirement for non-trading book positions subject either to commodity risk or both to commodity and foreign exchange risk assigned to trading desks in accordance with the alternative internal model as set out in Chapter 1b of part 3, title IV of Regulation (EU) No 575/2013, institutions shall use the last available fair value of those positions. Institutions shall fair value those positions on a daily basis.

2. In relation to non-trading book positions subject to commodity risk and not to foreign exchange risk, institutions shall apply scenarios of future shock, for the purposes of calculating the expected shortfall risk measure referred to in Article 325bb of Regulation (EU) No 575/2013 or the stress scenario risk measure referred to in Article 325bk of that Regulation, only to risk factors that belong to the commodity broad risk factor category.

3. In relation to non-trading book positions subject to commodity risk and foreign exchange risk, institutions shall apply scenarios of future shock for the purpose of calculating the expected shortfall risk measure referred to in Article 325bb of Regulation (EU) No 575/2013 or the stress scenario risk measure referred to in Article 325bk of that Regulation, only to risk factors that belong to the commodity or foreign exchange broad risk factor category.

Article 5

Computation of the hypothetical and actual changes related to non-trading book positions subject to foreign exchange risk or commodity risk under Article 325bf and Article 325bg of Regulation (EU) No 575/2013

1. By way of derogation from Articles 1 to 4 of Delegated Regulation (EU) (…/…), institutions computing the hypothetical and the actual changes in the portfolio's value referred to in Article 325bf and Article 325bg of Regulation (EU) No 575/2013 in relation to a non-trading book position which is subject to foreign exchange risk and not to commodity risk shall calculate the value of that non-trading book position at the end of the day following the computation of the value-at-risk number referred to in Article 325bf of that Regulation by using the value of that non-trading book position at the end of the previous day and updating its component reflecting the foreign exchange risk.

2.Where the value of a non-trading book position does not change linearly with movements in an exchange rate to which it is subject, institutions may, in derogation from paragraph 1, calculate the value of that non-trading book position at the end of the day following the computation of the value-at-risk number by using the value of that non-trading book position at the end of the previous day and updating all the components the institution uses to value that non-trading book position, including those components not pertaining to the foreign exchange risk broad risk factor category.

Where applying this paragraph, institutions shall apply it consistently to all positions in the trading desk that do not change linearly with movements in an exchange rate to which they are subject.

3. By way of derogation from Articles 1 to 4 of Delegated Regulation (EU) (…/…), institutions computing the hypothetical and the actual changes in the portfolio's value referred to in Article 325bf and Article 325bg of Regulation (EU) No 575/2013 in relation to a non-trading book position which is subject to commodity risk shall calculate the value of that non-trading book position at the end of the day following the computation of the value-at-risk number referred to in Article 325bf of that Regulation in accordance with either of the following, provided that they use it consistently for all positions subject to commodity risk in the trading desk:

(a) institutions shall use the value of that non-trading book position at the end of the previous day and update only the components reflecting the foreign exchange and commodity risk, or
(b) institutions shall use the value of that non-trading book position at the end of the previous day and update all the components the institution uses to value that non-trading book position, including those not pertaining to the foreign exchange or commodity risk broad risk factor categories.

4. Institutions shall apply paragraphs 1-3 only to non-trading book positions that are included both in the portfolio on the day of the computation of the Value-At-Risk number referred to in Article 325bf of Regulation (EU) No 575/2013, and in the portfolio on the day following the computation of that Value-At-Risk number.

Article 6

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

For the Commission
The President

[For the Commission
On behalf of the President

4. Accompanying documents

4.1 Draft cost-benefit analysis/impact assessment

Article 325(9) of CRR2 requires the EBA to develop draft RTS to specify how institutions should calculate the own funds requirements for non-trading book positions that are subject to FX risk or commodity risk where using the FRTB SA and the FRTB IMA.

As per Article 10(1) of Regulation (EU) No 1093/2010 (EBA Regulation), any regulatory technical standards developed by the EBA shall be accompanied by an Impact Assessment (IA), which analyses 'the potential related costs and benefits'.

This section presents the cost-benefit analysis of the main policy options included in the RTS. Given the nature and the scope of the RTS, the impact assessment is high level and qualitative in nature.

A. Problem identification and baseline scenario

Under CRR2, institutions are required to calculate capital requirements for market risk for:

- positions held in the trading book; and
- positions held in the banking book (i.e. non-trading book positions) subject to FX risk and commodity risk.

Article 105 requires institutions to revalue trading book positions at fair value on at least a daily basis. However, it does not set any specific requirements with respect to the valuation of banking book positions in the context of the calculation of the own funds requirements for market risk associated with those positions. The lack of such a specification can result in inconsistent implementation of the capital requirements for market risk for banking book positions subject to FX risk and commodity risk across institutions in the EU.

B. Policy objectives

The specific objective of the RTS is to establish common requirements for:

- the valuation of FX and commodity non-trading book positions;
- the specifications of the calculation of hypothetical and actual changes for the purpose of the backtesting and the profit and loss attribution test for positions in the non-trading book.

Generally, the RTS aim to create a level playing field, promote convergence of institutions' practices and enhance the comparability of own funds requirements across the EU. Overall, the RTS are expected to promote the effective and efficient functioning of the EU banking sector.

C. Options considered, cost-benefit analysis and preferred options

This section presents the main policy options discussed during the development of the Consultation Paper, the costs and benefits of these options, and the preferred options included in the final draft RTS.

Valuation of non-trading book positions attracting FX risk

In general, positions in the banking book (i.e. non-trading book) are not fair valued; however, institutions may for disclosure purposes – depending on the accounting standards implemented in the institution's jurisdiction – fair value all banking positions, e.g. on a quarterly basis. Against this background, the following options were assessed regarding the value of a non-trading book position that should be used as a basis for computing own funds requirements for FX risk.

Option 1a: Institutions should fully revalue non-trading book positions at fair value on a daily basis and use that fair value as a basis for calculating the relevant risk measures that are needed for obtaining the own funds requirements for FX risk.

Option 1b: Institutions should use either the last available accounting value or the fair value of banking book positions as a basis for calculating the relevant risk measures that are needed for obtaining the own funds requirements for FX risk and update only the FX component of these positions. The frequency at which updates are performed should be monthly for non-trading book positions capitalised under the alternative SA and daily for those capitalised under the alternative IMA.

Option 1a would force institutions to fair value on a daily basis non-trading book positions, which they probably would otherwise not do, only for the purpose of calculating capital requirements. Although it would allow consistency with the procedure for trading book positions, it would be overly burdensome for institutions relative to the benefits that such a potential requirement would bring.

On the other hand, Option 1b allows institutions to use either the last available accounting value or the fair value as the basis for the calculation, while requesting only the FX component of the banking book positions to be revalued on a more frequent basis. In other words, the positions are not revalued daily (i.e. the value in the currency of denomination is not updated daily, e.g. to capture changes in the credit risk component of the item), but the value of such positions in the reporting currency is adjusted – daily for the alternative IMA/monthly for the alternative SA – to consider the effect of the fluctuation of the exchange rate between the reporting currency and the currency of a particular transaction. This option is more in line with institutions' current practices and is expected to reduce the operational burden, while still reflecting the most recent FX rate in the value of the positions. The choice of monthly frequency for the alternative SA is in line with FRTB standards, where institutions are required to compute the own funds requirements for market risk under the SA on a monthly basis. The choice of daily frequency for the alternative IMA is aligned with the (daily) frequency for calculating the relevant risk measures that are needed to obtain the own funds requirements for FX risk (e.g. expected shortfall measure, VaR measure, etc.)

Option 1b is preferred. In order to avoid any sort of regulatory arbitrage, the final draft RTS propose that institutions should use the same kind of valuation (either accounting or fair value) for all banking positions. In addition, it is clarified that institutions are free to use the fair value as long as the fair valuing of banking book positions is performed at least on a quarterly basis. Finally, the same valuation treatment is prescribed for the SA and IMA, with the only difference being the frequency at which the update of the FX component should be performed.

Non-monetary items at historical cost under the standardised approach

In general, non-monetary items are booked at historical cost and do not change their balance sheet value with the movements in the exchange rates. However, in case of an indication of an impairment (due to a sharp move in the FX rate and/or other circumstances) the carrying amount of an asset is the lower of:

- its carrying amount before considering possible impairment losses (using the FX rate on the date of the transaction);
- its recoverable amount (using the FX rate on 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.

The EBA acknowledges that the sensitivity-based method may not be fit for the purpose of calculating the own funds requirements for foreign exchange risk stemming from non-monetary items that are held at historical cost, as it was not designed to capture this type of impairment risk. From a technical perspective, the delta risk of items that are held at historical cost is zero, as their balance sheet value does not change with fluctuations in exchange rates. As a result, the FX risk associated with those items would not be capitalised under the SA.

Against this background, two options were considered for how to capture FX risk for historical cost positions:

Option 2a: Setting a delta risk equal to zero.

Option 2b: Treating those items as linear in the FX rate (i.e. delta-1 product).

Option 2a acknowledges that the FRTB SA is not designed to capture the FX risk stemming from non-monetary items (e.g. impairment risk) and proposes setting the Pillar 1 requirements to zero. While this could be considered to be the most technically clean solution, it should be noted that such treatment would fail to capture any impairment risk, even if it would not pre-empt national competent authorities capturing such risk under Pillar 2 requirements.

However, from a prudential perspective, the EBA believes that it is important that the foreign exchange risk of those items is captured under the Pillar 1 requirements (as this is the case for all other instruments), as it would ensure a harmonised treatment across the EU. Accordingly, as part of these draft RTS, the EBA considered Option 2b, which treats items at historical cost as linearly dependent on the FX rate (i.e. delta-1 product) and requires the institution to update the FX component on a monthly basis, as for all other instruments. Such treatment is deemed to be the least burdensome from an operational perspective and still captures the FX risk stemming from these items under Pillar 1.

Option 2b is preferred. It should be highlighted that non-monetary items at historical cost are typically structural. Accordingly, the FX risk position associated with these items may be waived as part of the structural FX provision (if the institution applies for the structural FX waiver). Therefore, the costs of Option 2b should be understood in the context of the wider regulatory framework and not solely in the context of these RTS.

Specification of the HPL and APL for non-trading book positions subject to FX risk (and not to commodity risk)

As described in Option 1b, the draft RTS do not require a daily fair valuation of the instruments bearing FX risk (and not commodity risk). Instead, for items bearing FX risk, only a daily fair valuation of the FX component is required under the alternative IMA. Accordingly, for example, an institution that is fair valuing its banking book positions on a quarterly basis will observe bumps in the value of its portfolio at the full revaluation date that are not triggered by FX risk factors. Consequently, these bumps may lead to overshootings in the backtesting, which are unrelated to changes in the FX risk component of the price.

The EBA has considered the following options for clarifying the definitions of HPL and APL.

Option 3a: Do not consider specific definitions for HPL and APL.

Option 3b: Allow for specific definitions of HPL and APL to address the problem of having bumps in the value of the portfolio at the full revaluation date, while reflecting challenges that institutions may face in implementing this specific adjustment.

Under Option 3a, on the fair-valuing date, institutions could experience overshootings in the backtesting that are unrelated to the changes in the foreign exchange risk component of the price. Alternatively, Option 3b would allow the institution at time t, when it is fully revaluing its banking book positions, to calculate APL/HPL = $V_t - V_{t-1}$ for the purpose of backtesting VaR_{t-1}, using a value of the portfolio in t, V_t, which ignores that at time t a full revaluation of the banking book positions has been performed. Accordingly, where calculating V_t, the institution should be allowed to take the last fair value of the banking book positions available (before time t) as a basis and update the FX component with the FX rate at time t. In this way, the fair value basis over which the FX component is updated will be the same, and any overshooting will be due only to changes in the FX risk component. Option 3b provides for a practical solution to address the problem of artificial overshootings on the date of full revaluation.

While, in general, respondents to the Consultation Paper agreed with the above definitions for HPL and APL for non-trading book positions attracting FX risk, some respondents highlighted that it may be operationally challenging to capture only the changes in the FX components when computing HPL and APL. The EBA decided to amend the draft RTS proposed for consultation to reflect these challenges. In particular, institutions will be allowed to calculate the HPL and APL by reflecting the changes in all the components determining the value of the non-trading book positions, instead of only changes in the FX components. This possibility is limited to non-trading book positions, the value of which does not change linearly with changes in the relevant exchange rate, since for those that are linear a full revaluation-based P&L coincides with a sensitivity-based P&L, and as such fulfilling the requirements presented in the Consultation Paper should not pose operational issues to institutions. It should be noted that reflecting changes in all components for the purpose of computing the HPL and APL actually means fully revaluing the non-trading book position on a daily basis. Thus, for those positions for which the institution reflects all changes in the HPL and APL, the institution is not required to just update the foreign exchange risk factors from the last available value to obtain the value that is used as a basis for computing the own funds requirements. Instead, the institution is required to update all risk factors on a daily basis.

Option 3b is preferred.

4.2 Feedback on the public consultation

The EBA publicly consulted on the draft proposal contained in this paper. The consultation period lasted for 5 months[5] and ended on 10 June 2020. Seven responses were received, of which five were published on the EBA website as non-confidential.

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, several industry bodies made similar comments, or the same body repeated its comments in its responses to different questions. In such cases, the comments and the EBA's analysis have been included in the section of this paper where the EBA considers them most appropriate.

Changes to the draft RTS have been incorporated as a result of the responses received during the public consultation.

Summary of key issues and the EBA's response

In the feedback table below, the EBA has summarised the comments received and explains which responses have and have not led to changes and the reasons for this. With the exception of the treatment proposed for the capitalisation of non-monetary items held at historical cost, respondents broadly agreed with the provisions put forward in the draft RTS for consultation.

In detail, respondents agreed that they should be allowed to use the accounting value of non-trading book positions as a basis for computing the own funds requirements for foreign exchange risk and that institutions should not be required to perform a full revaluation of those positions. Some respondents mentioned that it could be excessive to require institutions using the SA to update the foreign exchange component on a daily basis and requested the EBA to amend the draft RTS to reflect this concern. In light of the comments made, and considering that the FRTB sets out that institutions are to calculate and report the own funds requirements for market risk on a monthly basis for those positions capitalised using the SA, the EBA decided to amend the draft RTS to require at least a monthly update of the foreign exchange component related to non-trading book positions. The requirement to update that component daily has, however, been kept for institutions capitalising the foreign exchange risk stemming from banking book positions using the IMA.

All respondents to the Consultation Paper on which these final draft RTS are based were critical of the treatment proposed for the capitalisation of non-monetary items at historical cost. In particular, a clear preference for a Pillar 2 requirement treatment was highlighted. None of the respondents put forward a proposal with respect to the capitalisation of those items under the Pillar 1 requirements that could ensure a harmonised treatment across institutions in the Union and that would fit with the provisions included in the CRR (i.e. the sensitivity-based method). As better detailed in the background section, the EBA does not deem prudent an exclusion of the foreign exchange risk stemming from non-monetary items at historical cost from the Pillar 1 requirements.

[5] The usual 3-month consultation period was extended by 2 months due to the COVID-19 outbreak.

It should be noted that these RTS are relevant in the context of the alternative SA, which is in place only for reporting purposes. The alternative SA, as currently framed in CRR2, does not foresee any treatment for structural FX positions, i.e. CRR2 does not allow banks to exclude any FX position from the calculation of own funds requirements under the alternative SA.

When it comes to the current SA, which is used for capital purposes, the EBA has addressed the concerns from respondents in the guidelines on structural FX[6]. Specifically, the structural FX guidelines clarify the following points.

- At the solo level, the competent authorities are expected to recognise as structural investments in subsidiaries. Those items are in general kept at historical cost.

- Non-monetary items at historical cost are not subject to the cap imposed by the maximum open position, as defined in those guidelines.

Thus, for capital purposes, investments in subsidiaries are expected to be waived as part of the structural FX provision, and the corresponding FX risk is not to be capitalised as part of the Pillar 1 requirements under that scenario. However, the exclusion is the result of the assessment performed by the competent authority, which is expected, for example, to check that the item is actually structural (e.g. that the institution does not intend to sell the subsidiary in accordance with its business strategy). The EBA deems such supervisory assessment warranted.

Considering that:

(i) the EBA expects CRR3 to finally include the possibility for banks to remove structural positions from the scope of positions subject to FX risk; and

(ii) the EBA expects that the above-mentioned favourable treatment for investment in the subsidiaries under the structural FX provision will also be kept under the FRTB SA;

the EBA decided to keep the treatment proposed for consultation.

As regards the definitions proposed for HPL and APL, in general, respondents to the Consultation Paper on which these final draft RTS are based accepted them; however, it was also mentioned that for institutions it may be operationally challenging to capture only the changes in the FX components when computing the HPL and APL. On that basis, it was proposed that the operational issue should be addressed by allowing institutions to use a sensitivity-based P&L to obtain the HPL and APL changes in the portfolio's value. Following such feedback, the EBA decided to amend the draft RTS to allow banks to reflect changes in all components determining the value of non-trading book positions when computing the HPL and APL, as long as such non-trading book positions are non-linear with regard to changes in the relevant exchange rate.

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

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

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
General comments			
Possibility of using internal models for non-monetary items (NMIs) at historical cost	One respondent agrees with the provision that allows institutions that use the internal model for market risk to capitalise the FX component of NMIs held at historical cost under the internal model.	The EBA acknowledges that institutions with advanced risk modelling techniques should leverage that expertise; thus, institutions allowed to use internal models for the relevant market risk category should be allowed to use the internal models for the purposes of these RTS. The EBA takes note of the positive feedback received.	No amendments.
Capitalisation of items that do not affect the P&L under Pillar 1	One respondent states that items that do not affect the P&L, such as NMIs held at historical cost, should not be capitalised under Pillar 1.	The EBA is of the view that the CRR does not limit the scope of Pillar 1 capital requirements to risks that materialise in the accounting P&L. Further details can be found in the analysis of the responses to Question 4.	No amendments.
Definition of impairment risk stemming from FX	One respondent states that the term 'impairment' should be replaced by 'diminution of value' in the context of the RTS because the former term has broader implications, including in the context of International Financial Reporting Standard (IFRS) 9.	The EBA decided to keep the terminology unchanged, as it does not expect this to be misinterpreted by persons subject to the regulation.	No amendments.

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
Definition of NMIs	In order to preserve the level playing field, one respondent asks the EBA to provide clarity over the definition of NMI, which varies across accounting standards and jurisdictions and is subject to different interpretations by institutions.	The EBA decided to amend the draft RTS, avoiding any reference to the term 'non-monetary items at historical cost' subject to the risk of an impairment. Specifically, those items can be equivalently identified as those meeting all the following conditions: - items that are not fair valued; - items that may be impaired due to FX risk; - items whose accounting value is not updated at each reporting date to reflect changes in the exchange rate between a foreign currency and the reporting currency of the institution.	Amendments to Article 1 and Article 3.
Responses to questions in Consultation Paper EBA/CP/2020/01			
Question 1. Do you agree with the approach in relation to the use of the accounting value and alternatively the fair value as a basis for computing the own funds requirements for foreign-exchange risk, or do you think that institutions should be requested to use e.g. only the accounting value? Please elaborate.	All respondents agree that institutions should be granted the possibility to use accounting values or alternatively fair values. All respondents believe that the accounting value should be the default measurement, particularly for non-trading book positions, implying that the accounting value stems from the business model and positions that are not in the trading book are not necessarily accounted for at fair value. One respondent states that a strict interpretation of the use of the book value should be avoided to allow banks flexibility concerning their technical	The EBA notes that all respondents agreed with the possibility for banks to use either the accounting value or the fair value for calculating the own funds requirements for FX risk. The EBA decided to leave that option in the final draft RTS.	No amendments.

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	equipment (i.e. banks should be able to use sufficiently accurate book values). Two respondents highlighted the reference to FRTB MAR11.4, which explicitly states that no FX risk capital requirements should be applied to positions related to the items that are deducted from a bank's capital when calculating its capital base, or to positions of a structural nature as per EBA-CP-2019-11. Some respondents suggest that the regulation gives leeway to institutions to match the risk components hedged under different accounting valuation regimes. For example, when using derivatives to hedge foreign currency-denominated cash flows of an amortised item, by establishing a cash flow hedge relationship, the FX exposure will be completely closed. However, asymmetries in the account value by currency will appear. Furthermore, Article 33 of the CRR indicates that valuations of cash flow hedges are not considered subject to capital requirements when hedging amortised cost items.	The EBA acknowledges the fact that FRTB standards stipulate that positions related to items deducted from an institution's capital are not subject to an FX risk capital requirement. In the context of a call for advice, the EBA recommended including such a specification in the level 1 text. However, the EBA is not mandated to specify in these draft RTS the scope of items attracting the FX charge. Instead, the EBA is mandated to specify how institutions are to compute those requirements according to the scope identified by level 1. Thus, the EBA cannot include such a specification in these draft RTS. With respect to the point raised around Article 33, the EBA agrees with the comments received; however, as mentioned above, the EBA does not have any mandate to clarify the scope of items attracting FX own funds requirements. Thus, the EBA cannot address this comment in these draft RTS.	
Question 2. Do you agree that institutions should be requested to update on a daily basis only the foreign-exchange risk component of banking book instruments? Please elaborate.	Some respondents agree with the proposal. One respondent suggested clarifying that a daily revaluation of the underlying asset can be updated for parts of transactions faster than other exposures depending on their technical needs. Other respondents argue that the daily computation of own funds for FX risk for most	Following the comments made by some respondents to the consultation, and considering that the FRTB sets out that the 'standardised approach must be calculated and reported to the relevant supervisor on a monthly basis', the EBA decided to amend these draft RTS so as to require institutions to update the FX component on at least a monthly basis.	Amendments to Article 1.

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	banking book positions under the SA by valuing only the FX component might be an excessive requirement and that daily reporting would be inconsistent with the availability of financial statements. They suggest allowing institutions that apply the SA to have the flexibility to compute own funds for FX risk less frequently than daily or to compute them in accordance with applicable accounting reporting. One respondent explicitly added that capital requirements calculation for own funds requirements for the FX risk of instruments in the banking book are required only on a monthly basis and reporting is carried out on a quarterly basis.		
Question 3. Could you please describe the current risk-management practices that institutions use for managing the foreign exchange risk stemming from banking book positions, e.g. whether the accounting or the fair value is used as a basis for determining the exposure in a currency, the frequency at which banking book positions are fully revalued, the frequency at which the foreign-exchange component is updated?	Most respondents replied that, in general, the accounting values are used for determination of the exposures of banking book positions. Some respondents added that for traded instruments the fair values are generally updated daily but at least monthly, while for non-traded instruments a fair value calculation follows the quarterly IFRS reporting frequency, and that the FX component is updated on a daily basis. Some respondents furthermore replied that monetary assets/liabilities are revaluated daily using fixing rate through P&L and non-monetary assets/liabilities are revaluated at historical cost or at the revaluation date. Additionally, an entity shall assess at the end of each reporting period whether	The EBA takes note of the answers provided by the respondents and deems the framework proposed in the RTS to fit with current practices. Comments on the non-monetary items at historical cost have been addressed in the relevant question.	No amendments.

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	there is any indication that a non-monetary asset may be impaired. If any such indication exists, the entity shall estimate the recoverable amount of the non-monetary asset, which includes the fair value decrease and FX impact.		
Question 4. Do you agree with the proposed methodology for capturing the foreign exchange risk stemming from non-monetary items at historical cost under the standardised approach? Do you have any other proposal for capturing the foreign exchange risk stemming from non-monetary items at historical cost that would be prudentially sound while fitting within the standardised approach framework? Please elaborate.	Several respondents believe that the inclusion of items at historical cost with the proposed linear methodology is conservative (especially for stable currencies, where the probability of impairments is comparatively low). It is mentioned that an impairment for participation in a foreign subsidiary could derive from a general deterioration of the economic conditions of the hosting country that might well be associated with a depreciation of its currency. Disentangling the domestic effects from the FX ones, it is hard to identify cases in which FX depreciation alone eventually leads to an impairment. In fact, impairments depend on many parameters, and the risk of impairments due to FX movements may be remote according to those respondents. Therefore, some respondents recommend allowing the full exclusion of items at historical cost or establishing criteria for reduced risk weights depending on the probability of an FX-induced impairment. One respondent said that the proposed approach conceptually overlaps with credit risk capitalisation.	The EBA notes that none of the respondents proposed an alternative methodology in keeping with the sensitivity-based method that would ensure a harmonised capitalisation of those items. On the one hand, the EBA agrees with some of the comments received, but on the other hand it believes that the framework proposed in the draft RTS presents several advantages. It should be noted that these RTS are relevant in the context of the alternative SA, which is in place only for reporting purposes. The alternative SA as currently framed in CRR2 does not foresee any treatment for structural FX positions, i.e. CRR2 does not allow banks to exclude any FX position from the calculation of own funds requirements under the alternative SA. When it comes to the current SA, which is used for capital purposes, the EBA has addressed the concerns from respondents in the guidelines on structural FX. Specifically, the structural FX guidelines clarify the following points.	Amendments to Article 1.

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	Some respondents mentioned that efficient hedges for risk-weighted assets generated from historical cost items are difficult to perform (without introducing open FX positions), as these positions do not automatically revalue with FX movements. Some respondents mentioned that the inclusion of items at historical cost is directly connected to the EBA guidelines on the treatment of structural FX under Article 352(2) of the CRR. According to these respondents, regulatory approval for exclusion of such items generates an overly complex, resource-intensive and time-consuming process. Some respondents said that they see a possible overlap between inclusion of subsidiaries at historical cost and the systemic risk buffer and O-SII buffer that would lead to double coverage of the same risks. One respondent said that there is a possible overlap between Pillar 2 add-ons. One respondent said that the term ‘diminution of value’ is more appropriate in the context of FX risk than the term ‘impairment’, as the latter has further connotations, including provisioning under IFRS 9. Furthermore, some respondents said that the regulatory framework set out by the CRR does not provide a clear definition of non-monetary items and refers to accounting standards as a general description. This could be misleading, as there are deviations across the accounting standards, jurisdictions and legal entity structures, and different interpretations among banks. Therefore,	- At the solo level, the competent authorities are expected to recognise as structural investments in subsidiaries. Those items are, in general, kept at historical cost. - Non-monetary items at historical cost are not subject to the cap imposed on the maximum open position as defined in those guidelines. Thus, for capital purposes, investments in the subsidiaries are expected to be waived as part of the structural FX provision, and the corresponding FX risk to not be capitalised as part of the Pillar 1 requirements under that scenario. However, the exclusion is the result of the assessment performed by the competent authority, which is expected to check, for example, that the item is actually structural (e.g. that the institution does not intend to sell the subsidiary in accordance with its business strategy). The EBA deems such supervisory assessment warranted. Considering that: (i) the EBA expects CRR3 to finally include the possibility for banks to remove structural positions	

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	the EBA should provide a better definition of non-monetary items or should define non-monetary items for prudential purposes. Some respondents said that the assignment of the currency in question is not in line with Article 24 of the CRR, which requires the valuation of assets and liabilities to be effected in accordance with the applicable accounting framework. For example, according to the IFRS, items at historical cost are denominated in the functional currency of the entity in which they are accounted for. Accordingly, based on the level 1 text, those items do not affect the net open position. Some respondents said that neither in the CRR nor in the Basel framework is there an example of a Pillar 1 capital charge that would not have an impact on the P&L statement. Given that the impacts of FX rates on investments in subsidiaries do not affect the P&L statement (both at the consolidated level and at the individual level), they therefore disagree with the proposed methodology. In order to align the SA and the IMA, some respondents suggest allowing individual modelling as an alternative for SA banks.	from the scope of positions subject to foreign exchange risk; and (ii) the EBA expects that the above-mentioned favourable treatment for investment in the subsidiaries under the structural FX provision will also be kept under the FRTB SA; the EBA decided to keep the treatment proposed for consultation. The EBA slightly amended the proposed treatment for the identification of the currency of denomination associated with non-monetary items that are held at historical cost to ensure a correct currency assignment.	
Question 5. How are you currently treating, from a prudential perspective, non-monetary items at historical	Some respondents said that items at historical cost are currently not included in Pillar 1 capital	The EBA believes that, from a prudential perspective, it is important that the FX risk of non-monetary items at historical cost is captured under the Pillar 1 requirements. The EBA kept the treatment presented	No amendments.

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cost that may be subject to an impairment due to a sharp movement in the foreign exchange rate? In which currency are those items treated from an accounting perspective?	requirements. These items are included in the Pillar 2 framework (e.g. via stress tests).	for consultation around the capitalisation of NMI at historical cost under the SA.	
Question 6. Could you please provide an estimate of the materiality of non-monetary items that are held at historical cost for your institution (e.g. size of the non-monetary items at historical cost with respect to the institution's balance sheet)? Please elaborate.	Some respondents mentioned that participation in subsidiaries held at historical cost is material from a solo perspective. From a consolidated perspective, items in FX held at historical cost are not material.	The EBA acknowledges that participation in subsidiaries held at historical cost is material from a solo perspective and that non-monetary items at historical cost are material from that perspective only, i.e. they are not material at the consolidated level.	No amendments.
Question 7. Do you think there are any exceptional cases where institutions are not able to meet the requirement to daily fair value commodity positions? Would these exceptional cases occur only for commodity positions held in the banking book or also for commodity positions held in the trading book?	One respondent assumed that the daily fair valuing of commodity positions would provide smaller banks with challenges and high costs (e.g. through higher fees for the supply of daily market data). Two respondents replied that it is possible for institutions to take ownership of commodities in the banking book in which no daily prices are available. This could be, for example, as a result of a restructuring or the taking of a commodity that had previously been provided as collateral and for which no liquid markets exist. On such assets, valuation methodologies for capital requirements should be no different to the valuation requirements for	To ensure consistency with the changes made following the feedback on the Consultation Paper on the treatment of positions attracting FX risk, the EBA decided to amend the draft RTS to allow a monthly fair valuation of commodity positions for institutions using the SA. Along the same lines, the requirement for a daily revaluation has been kept for institutions using the IMA for capitalising the commodity risk in the non-trading book.	Amendments to Article 2.

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	accounting purposes. They do not see the same issues arising in the trading book.		
Question 8. Do you agree that, with respect to the valuation of foreign exchange and commodity positions held in the banking book, the provisions applicable in the context of the alternative standardised approach (Article 1, paragraphs 1 and 2) should also apply in the context of the alternative internal model approach (Article 3, paragraphs 1 and 2)? Please elaborate.	Some respondents agree with the proposal. Other respondents believe that banks should be allowed to use internal models for calculation if they have sufficient data to do so. This is because of the general principle that the measurement approach used to quantify a risk should not affect the scope of the relevant positions subject to that risk. In particular, all the considerations expressed before on the relevance of at-cost items in the context of FX-related market risk are also applicable under the IMA.	The EBA decided to keep the same overarching framework in the SA and in the IMA with respect to the valuation of non-trading book positions subject to foreign exchangeFX or commodity risk. However, as already mentioned, institutions using the SA are required, under the final draft RTS, to update the foreign exchange and commodity components only on a monthly basis.	Amendments to Articles 1 and 2.
Question 9. Do you agree with the provision requiring institutions to model the risk that non-monetary items at historical cost are impaired due to changes in the relevant exchange rate or do you think that the RTS should be more prescribing in this respect? Please elaborate.	Most respondents agree with the provision requiring institutions to model the risk that NMIs held at historical cost are impaired due to changes in the relevant exchange rate. One respondent, while agreeing with the general principle, states that IMA institutions should be allowed flexibility in modelling the impairment risk stemming from FX, without further guidance. Some respondents do not agree with the provision because the modelling of impairment risk as a consequence of FX risk is very unlikely and artificial. In their view, the FX component is not material and is very unlikely to trigger the impairment of NMIs at	The EBA agrees that there is no need to provide further guidance on the modelling of the risk that NMIs at historical cost are impaired due to changes in the relevant exchange rate. The EBA considers this risk to be part of the market risk framework, to be capitalised under Pillar 1. Nevertheless, the EBA expectation is that most positions stemming from NMIs held at historical cost will be waived according to the guidelines on the treatment of structural FX positions.	No amendments.

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	historical cost. The impairment is more likely to be triggered by the credit risk component; thus, there is a possible overlapping between the two components (FX and credit risk). Furthermore, even in the unlikely event that the FX component triggered an impairment, the respondents believe that it should be capitalised under the credit risk framework. One respondent proposes capturing the impairment risk due to FX risk in Pillar 2.		
Question 10. How institutions would capture the risk of an impairment in their risk-measurement model? Would the definition of impairment used in the internal model be identical to the one proposed in the accounting standards? Please elaborate.	For some respondents, there is not an available methodology for modelling the impairment risk in the internal model. In their view, the starting point should be the accounting value, to which the techniques available for the quantification of tail risk apply. One respondent maintains that the FX risk is not fit for impairment purposes since it is just a minor component of the possible elements that may trigger an impairment, and hardly its cause. Nevertheless, in case the provision is left unchanged, the respondent states that the starting point should be the definition of impairment used in accounting standards.	The EBA takes note of the answers provided by the respondents and encourages the industry to develop adequate modelling techniques.	No amendments.
Question 11. Do you think that the requirement to capture the impairment risk in the risk-measurement model for institutions using the internal model approach is less or more	Two respondents agree that the requirement proposed to capture the impairment risk in the risk-measurement model for institutions using the IMA is less conservative, although more complex, compared with the one envisaged for institutions using the SA.	The EBA takes note of the answers provided by the respondents and confirms that the use of the IMA for modelling the risk that NMIs at historical cost are impaired due to changes in the relevant exchange rate is available only for institutions authorised to use the IMA for the relevant risk category.	No amendments.

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
conservative than the requirement proposed for institutions using the standardised approach? Please elaborate.	One respondent states that the modelling approach should be granted for all institutions, including those not authorised to use the IMA. One respondent reports that it is not in a position to estimate the conservativeness of the proposed approach. One respondent states that the impact of the requirement cannot be estimated a priori, but on theoretical grounds the approach envisaged for institutions using the standardised approach is more conservative than the one envisaged for institutions using the internal model approach.		
Question 12. Do you agree with the definitions of HPL and APL changes in the portfolio's value deriving from non-trading book positions that have been included in the proposed draft RTS?	Some respondents agree with the proposed approach. One respondent agrees with the definitions of HPL and APL changes provided by the RTS, as it is conceptually coherent with how the banking book risks should then be modelled under the IMA. However, some respondents disagree with the proposed backtesting and PLA test requirements because the notion of a hypothetical portfolio is inappropriate in a non-trading book context. In accordance with these respondents, it would be very difficult to use official accounting systems to produce APL and HPL for banking book purposes. Sterilising portfolio changes could be very complicated and require a significant overhaul of banks' specific systems and practices, and could	The treatment proposed for consultation is consistent with the way foreign exchange risk should be modelled under the IMA. Thus, the EBA decided to retain it as a default treatment. The EBA acknowledges that there may be positions for which it may be challenging to isolate changes related to foreign exchange risk factors when calculating the APL and HPL changes. Thus, the final draft RTS allow institutions to recognise changes in all the components determining the value of a non-trading book position, as long as the value of such a position is non-linear in the exchange rate.	Amendments to Article 5.

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	require decoupling of the calculation of the banking book backtesting-relevant P&L from other P&L calculations. It was proposed that the use of sensitivity-based approaches for the calculation of FX impacts in the banking book be allowed.		