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Consultation Paper

On Draft Regulatory Technical Standards on the treatment of structural FX positions under Article 104c of Regulation (EU) No 575/2013 (Capital Requirements Regulation) and on the reporting on structural FX positions

Contents

1. Responding to this consultation

The EBA invites comments on all proposals put forward in this paper and in particular on the specific questions summarised in 5.2.

Comments are most helpful if they:

- respond to the question stated;
- indicate the specific point to which a comment relates;
- contain a clear rationale;
- provide evidence to support the views expressed/ rationale proposed; and
- describe any alternative regulatory choices the EBA should consider.

Submission of responses

To submit your comments, click on the 'send your comments' button on the consultation page by 07.02.2025. Please note that comments submitted after this deadline, or submitted via other means may not be processed.

Publication of responses

Please clearly indicate in the consultation form if you wish your comments to be disclosed or to be treated as confidential. A confidential response may be requested from us in accordance with the EBA's rules on public access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the EBA's Board of Appeal and the European Ombudsman.

Data protection

The protection of individuals with regard to the processing of personal data by the EBA is based on Regulation (EU) 1725/2018 of the European Parliament and of the Council of 23 October 2018. Further information on data protection can be found under the Legal notice section of the EBA website.

2. Executive Summary

The concept and specific application of the structural foreign exchange (FX) provision pursuant to Article 352(2) of Regulation (EU) No 575/2013 (the Capital Requirements Regulation, CRR) has been subject to several interpretations, across both supervisory authorities and institutions. The implementation of this provision has proved to be quite uneven across jurisdictions.

In order to ensure a harmonised EU interpretation and implementation of the treatment of structural FX positions, the EBA published in 2020 guidelines (GLs) on how to implement the structural FX provision contemplated in Article 352(2) of the CRR.

In light of the importance of the structural FX provision, also in terms of impact on the own funds' requirements, the co-legislators, as part of the CRR3 legislative process, introduced a mandate for the EBA to develop RTS in this regard.

The RTS presented for consultation overall keep the provisions included in the GLs. There have been only few changes compared to the GLs text, namely:

- The introduction of a clear quantitative thresholds for a currency to be considered eligible for the structural FX treatment; this is proposed in view of reducing observed variability in the currencies that were considered relevant for the business under the GLs.

- The possibility for banks to consider only credit risk own funds requirements when determining the position neutralising the sensitivity to the capital ratios, as long as the credit risk own funds requirements are the one driving the variability of the ratio against FX changes;

- Clarifications around how institutions are to remove the risk position from the own funds requirements for foreign exchange risk;

- Provisions relating the institution's policies as regards currencies that are particularly illiquid in the market, for example, because of Union restrictive measures.

Based on the information provided by supervisors to the EBA, the changes introduced are not expected to lead to a material capital impact. The quantitative threshold for a currency to be considered eligible is expected to affect only credit institutions that have sought for an omnibus approval (i.e. approval for all currencies, regardless of the actual exposure held). On the contrary, the possibility for institutions to consider only credit risk own funds requirements when computing the maximum open position is expected to at least reduce the operational burden to which they are subject.

In addition to the RTS, setting out the policy framework for the treatment of S-FX positions, this consultation paper also presents a proposal for the reporting (to be included in the ITS on Supervisory Reporting) on S-FX permissions granted by competent authorities.

Next steps

The EBA will assess the feedback received during the public consultation, before submitting the final draft to the European Commission.

3. Background and rationale

1. The structural FX provision in Article 352 of Regulation (EU) No 575/2013 (CRR) has been subject to various interpretations that have led to differences in its application both between EU Member States and across institutions. To promote a harmonised approach within the EU, the EBA published in 2020 own-initiative guidelines (EBA/GL/2020/09) on the practical implementation of the 'structural FX' provision. Those GLs are now transposed into these RTS, following a mandate provided to EBA in the context of the CRR3 legislative process (see Article 104c of CRR as amended by CRR3).

2. It is important to note that, even if the guidelines related to the provision included in Article 352(2) of CRR, which refers to the pre-FRTB market risk framework (Basel II), they were developed also considering changes to the market risk framework introduced in the revised Capital Requirements Regulation (CRR2), which builds on the new FRTB standards published by the Basel Committee on Banking Supervision (BCBS) in January 2019, and taking into account the structural FX treatment envisaged in those standards. Accordingly, the RTS overall keeps the content of the GLs unchanged.

3. Accordingly, most of the provisions included in the RTS were already part of the GLs on structural FX. For approvals that were already granted under the provisions set out in the GLs, it is expected that competent authorities ensure the continuity of the institution's compliance with the new structural FX provision, in particular in relation to those aspects that were subject to amendments introduced by the RTS.

3.1 Overview of the provision and clarifications on the application of the structural FX treatment

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

5. Article 104c of the CRR states that:

1. An institution which has deliberately taken a risk position in order to hedge, at least partially, against adverse movements in foreign exchange rates on any of its capital ratios as referred to in Article 92(1), points (a), (b) and (c), may, subject to permission of the competent authorities, exclude that risk position from the own funds requirements for foreign exchange risk set out in Article 325(1), provided that all of the following conditions are met:

(a) the maximum amount of the risk position that is excluded from the own funds requirements for market risk is limited to the amount of the risk position that neutralises the sensitivity of any of the capital ratios to the adverse movements in foreign exchange rates;

(b) the risk position is excluded from the own funds requirements for market risk for at least 6 months;

(c) the institution has established an appropriate risk management framework for hedging the adverse movements in foreign exchange rates on any of its capital ratios, including a clear hedging strategy and governance structure;

(d) the institution has provided to the competent authorities a justification for excluding a risk position from the own funds requirements for market risk, the details of that risk position and the amount to be excluded from the own funds requirements for market risk.

2. Any exclusion of risk positions from the own funds requirements for market risk in accordance with paragraph 1 shall be applied consistently.

3. The competent authorities shall approve any changes by the institution to the risk management framework referred to in paragraph 1, point (c), and to the details of the risk positions referred to in paragraph 1, point (d).

4. EBA shall develop draft regulatory technical standards to specify:

(a) the risk positions that an institution can deliberately take in order to hedge, at least partially, against the adverse movements of foreign exchange rates on any of an institution's capital ratios referred to paragraph 1, first subparagraph;

(b) how to determine the maximum amount referred to in paragraph 1, point (a), and the manner in which an institution shall exclude this amount for each of the approaches set out in Article 325(1);

(c) the criteria that shall be met by an institution's risk management framework referred to in paragraph 1, point (c), in order to be considered appropriate for the purpose of this Article.

6. The provision allows competent authorities to authorise, on an ad hoc basis, the exclusion of FX risk positions deliberately taken by firms to hedge against the adverse effect of exchange rates on capital ratios from the calculation of the own funds requirements for foreign exchange risk.

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

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

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

9. The CRR3 text clarifies that the open position that can be exempted under the structural FX provision is capped by the open position neutralising the sensitivity of the capital ratio to changes in the exchange rate.

10. The methodology that institutions should use for calculating the open position neutralising the sensitivity of the capital ratio to movements in the exchange rate is discussed later in this background section.

11. There might be cases where the size of the open position generated by positions that are suitable for the exemption (and therefore potentially exemptible from the net open position) exceeds the maximum open position that can be exempted. Accordingly, these RTS set a clear distinction between FX positions that cannot be exempted because they are not suitable for the exemption (e.g. because they are not structural or because they are not taken for hedging the ratio) and FX positions that are not exempted only because of the cap imposed by the maximum open position.

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

Ratio to which the structural FX provision applies

13. Article 104 of the CRR refers to the ratios of the institutions, as defined in Article 92 CRR. Accordingly, the RTS were developed considering that institutions may apply for the waiver when hedging any of the three capital ratios with structural FX positions. Because the CET1 ratio is the ratio that typically attracts the most attention from external stakeholders, the expectation of the EBA would be that the CET1 ratio is the ratio that institutions will aim to hedge.

14. A position that is suitable for the exemption in the context of the structural FX provision applied to one ratio of the institution is also deemed suitable for the exemption in the context of the structural FX provision of another ratio of the institution. Where the institution perfectly hedges the total capital ratio, the T1 ratio and the CET1 ratio are over-hedged. Along the same lines, where the institution perfectly hedges the CET1 ratio, the T1 ratio and the total capital ratio are in general under-hedged. It is clear that the FX open position required to neutralise the sensitivity of the ratio to the FX rate depends on the ratio that the institution hedges. Accordingly, the number of FX positions that could be exempted from the net open position varies from ratio to ratio (as the maximum open position that can be exempted varies).

15. As a result of the previous paragraph, if the institution were calculating the maximum open position for each of the ratios, it would also obtain different own funds requirements for each of the ratios (as the positions that can be exempted would differ in size). To prevent such a situation from occurring, the RTS specify that the institution should choose the ratio it intends to hedge and, accordingly, develop a strategy with the purpose of hedging such a ratio (as also required by the CRR3 text).

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

17. The RTS also clarify that the ratio to be considered when computing the position neutralising the sensitivity is the current ratio, i.e. the ratio that the institution currently has (or the one calculated with the latest available figures), and not any form of ratio the institution plans to have or foresees having in the future. Accordingly, competent authorities should assess whether the FX risk positions hedge the current capital ratio and potentially grant the permission to exclude them from the net open position. To be noted that, since the institution is required to consider the actual ratio, it should also consider the ratio as resulting from the application of output floor if this happens to be hit.

Level to which the structural FX provision applies

18. Article 6 of the CRR determines that institutions shall comply with their market risk requirements on an individual basis, and Article 11 of the CRR establishes the obligation to comply with these requirements on a consolidated basis. Accordingly, institutions have to generally comply with the CRR requirements for market risk, including FX risk requirements, both on an individual and on a consolidated basis. Consequently, the waiver in Article 104c CRR could apply both on an individual and on a consolidated basis.

19. These RTS therefore consider specificities in applying the structural FX provision on an individual and on a consolidated basis. It is expected that a specific request is sent to the competent authority for each level at which the institution seeks permission to apply the structural FX treatment.

20. The need for a specific permission is because positions that have been taken for hedging the capital ratio at a consolidated level might not have a hedging effect on the capital ratio at a solo level (and vice versa). Accordingly, positions that might be exempted in one context might not receive the same prudential treatment (i.e. the exemption) in another context.

Risk position and net open position

21. An additional element of the current regulation related to FX positions that may be worth clarifying stems from the differences between simplified standardised, the standardised and the internal model regulatory frameworks. The treatment of structural FX is now established in Article 104c CRR. This article also refers directly to all three approaches that institutions may use

to compute the own funds requirements for foreign exchange risk. Hence, the provision in Article 104c CRR applies to banks under any of the three approaches.

22. Considering that there could be cases where the institution (at consolidated level) uses all three approaches, it is appropriate to introduce a semantic that is applicable to all. In particular:

    (i) By risk position, the RTS refer to the overall FX position that is taken/maintained for hedging the ratio. This risk position consists of FX positions corresponding to specific items/assets/liability.

    (ii) By net open position, the RTS refer to the FX position resulting by netting FX positions. Institutions are free to consider the net open position as either:

        - The net open position referred to in Article 352(1) CRR; or
        - The net delta sensitivity towards the relevant exchange rate.

Items that are deducted from the institution's own funds

23. According to Article 325(1) of the CRR, positions that are deducted from the institution's own funds are not subject to own funds requirements for foreign exchange risk. This is in line with the FRTB standards. Accordingly, given that these positions are excluded ex-ante, they cannot be subject to the S-FX permission. Accordingly, compared to the GLs, the RTS remove all provisions relating to items deducted from CET1.

Base currency treatment

24. Under CRR3, an institution must compute the own funds requirements using one reporting currency only (see last subparagraph of Article 325b(4) CRR). However, the institution may use the base-currency treatment referred to in Article 325q CRR (if does so, it has to do it for all banking and trading book positions and must still capture translation risk). The RTS specify that if the bank computes the foreign-exchange risk using a base currency (instead of the reporting currency), then the RTS themselves must be applied treating the base currency as the reporting currency (i.e. the institution cannot ask to waive positions denominated in the base currency, as FX risk is not computed in the first place for those positions), and the reporting currency as a foreign currency (i.e. the institution can ask for waiving position denominated in the reporting currency, given that the institution pays FX risk for those positions).

3.2 Introduction to the RTS and overarching requirements

25. As previously mentioned, the structural FX provision allows competent authorities to authorise, on an ad hoc basis, the exclusion of the risk position deliberately taken by firms to hedge against the adverse effect of the exchange rate on capital ratios from the calculation of the net open positions.

26. The EBA is of the view that the provision has a rather limited scope of application, as the hedging activity must be 'deliberately taken in order to hedge (at least partially) against the adverse movements of the exchange rate on its ratios'. Specifically, this is fundamentally different from hedging specific exposures and would indicate that only positions taken to hedge the overall FX risk of the capital ratios, i.e. at the level of the overall balance sheet of the institution, can be taken into consideration.

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

28. The RTS, similarly to the GLs, consider that a position to be considered as deliberately taken to hedge the ratio must meet the following conditions:

    1. The risk position is in a currency that is significant for the institution;

    2. The risk position hedges the ratio;

    3. The risk position is structural;

    4. The risk position is managed in accordance with the risk management framework whose criteria are laid down in these RTS.

29. It should be stressed that all four conditions are to be met. In particular, the fact that a position is structural does not necessarily mean that it is suitable for the exemption. The institution should always prove that a structural position has been taken for the purpose of hedging the ratio. Accordingly, there can be structural positions that are not suitable for the exemption (i.e. that do not meet all four conditions).

30. Requirements relating to risk-management framework are essential – indeed, whether a position is suitable for the exemption is strictly related to the way that the position is managed over time and accordingly it would be counterintuitive to, for example, define a specific set of conditions that structural positions should meet to be automatically identified as such without taking into account the risk management strategy of such positions (which is typical of the institution).

31. Here below, each of these four conditions is outlined in more concrete terms.

3.2.1 Significant currencies for an institution

32. Article 104c CRR refers to the adverse effect of the exchange rate between the reporting currency and any other currency. Accordingly, an institution may request permission to exclude

from the relevant net open positions FX risk positions in more than one currency. However, these RTS clarify that permission should be sought (and potentially granted) for currencies that are relevant to the business of the institution. In particular, positions in a currency that is not material (or relevant) for the institution should not be considered to be deliberately taken for hedging the ratio from the corresponding exchange rate; indeed, movements in such an exchange rate would negligibly affect the ratio.

33. These RTS take as a premise that the top ten currencies in terms of credit risk RWA of the institution are material. However, there might be other currencies that are actually relevant for the institution, e.g. when the institution performs its business in several countries with different currencies.

34. Accordingly, the institution may also ask for the permission referred to in Article 104c CRR for positions in currencies that are not among the top ten as long as the credit risk RWA in the foreign currency represent at least 1% of the overall credit RWA in foreign currencies.

3.2.2 Risk position hedging the capital ratio

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

Long nature of the open FX position

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

Example:

Parent bank (or subsidiary) reporting in EUR

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

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

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

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

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

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

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

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

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

Case A: permission sought on an individual basis

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

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

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

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

42. However, considering that there is a natural incentive for institutions to fulfil the requirement in point (i) of paragraph 40[1], these RTS do not include other minimum requirements reflecting this aspect. As a result, when the provision is applied on an individual basis, the only requirement set out in this section is the one in point (ii) of paragraph 40 (i.e. the risk position is net long).

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

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

44. When the permission is sought on a consolidated basis and the permission to offset the positions among all entities within the group has been granted, all rationales presented under Case A hold. Accordingly, also in this case, the only requirements set out in this section are

[1] If the institution excluded a long position from a short position, the institution would get an even shorter position to consider for capitalisation (i.e. the capital requirements would increase following the exclusion).

that the risk position for which exemption is sought is long and the numerator increases when the foreign currency appreciates.

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

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

46. Whether the permission in Article 325b CRR has been granted or not does change, however, the own funds requirement for market risk (and accordingly also the FX charge) included in the denominator.

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

Example:

Parent institution at solo level reporting in EUR:

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

Subsidiary at the solo level reporting in GBP:

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

Institution at a consolidated level reporting in EUR:

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

Suppose that the bank entered into a short position at the parent level (EUR 30 in GBP) to reduce the over-hedge[2] that the bank would have without such a position. Then, a short position has been actually taken for hedging the ratio and the hedging effect is present regardless of whether the permission in Article 325b CRR has been granted or not[3].

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

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

50. In general, when the permission in Article 325b CRR has not been granted (or only partially granted), the guidelines specify that a short position at the solo level (i.e. at subsidiary level or parent bank level) can be considered for the exemption at consolidated level only if it has been taken with the sole purpose of hedging the ratio at the consolidated level4. In addition, when the permission in Article 325b CRR has not been granted, these RTS require institutions to specifically describe how they manage positions that at the solo level are short for the purpose of hedging the ratio at a consolidated level.

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

[2] Over-hedge meaning that the net open position is greater than the position perfectly hedging the ratio.

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

[4] As explained, such short position must be in any case part of a long structural position at consolidated level.

Example:

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

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

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

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

2. *at the level of S2.*

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

Example:

Parent bank at solo level reporting in EUR:

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

Subsidiary at the solo level reporting in GBP:

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

Institution at the consolidated level reporting in EUR:

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

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

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

Delta risk and internal trades

52. The RTS prescribe that the risk position must be a delta risk position. There, banks cannot remove from the own funds requirements for market risk any non-delta risk e.g. vega position, on the basis that this has been taken for the purpose of hedging the ratio.

53. Furthermore, the RTS set out that internal trades between banking book and trading book cannot be considered part of the waiver. Internal trades do not impact the size of the net open position of the institution in the foreign currency – hence, it cannot be argued that the bank performs internal trades to achieve the objective of stabilizing the ratio. On the contrary, there may be cases where an institution transfers its trading book FX risk to the non-trading book for the purpose of meeting the condition set out in the next section (i.e. the fact that only non-trading book position can be subject to the waiver). Accordingly, in order to avoid regulatory arbitrage, the RTS make explicit that internal trades cannot be part of the waiver.

3.2.3 Risk position is structural

Limitation to banking book positions

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

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

56. Accordingly, it is deemed that only FX positions stemming from instruments for which the institution does not have trading intent (i.e. instruments held in the banking book) can possibly qualify for the exemption[5].

Positions of type A and B

57. The RTS include other conditions for a risk position to be considered structural. In particular, for the positions for which the exemption is sought, institutions should indicate whether they are positions of type A or positions of type B in accordance with the specifications in the paragraphs below. Positions of type A are positions for which the RTS recognise their structural nature, while positions of type B are positions for which the RTS require a deeper analysis to assess the structural nature.

58. The categorisation into positions of type A or positions of type B is meant to support the competent authority in analysing the application of the institution; in particular, such categorisation is meant to support supervisors in assessing whether the conditions that positions should meet for being suitable for the exemption are actually met, and represents a minimum level of granularity into which such positions need to be subdivided by the institution.

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

Case A: permission sought on an individual basis

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

61. Accordingly:

[5] It should be noted that the FRTB standards clarify that positions should be of a 'structural (i.e. non-dealing) nature', meaning that 'structural' and 'non-dealing' should be treated as synonymous.

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

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

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

Case B: permission sought on a consolidated basis

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

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

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

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

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

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

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

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

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

Example 1:

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

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

The subsidiary S has positions only in GBP.

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

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

Example 2:

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

3.2.4 Requirements applicable to the risk-management framework

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

69. The requirements included in this section represent the fourth condition to be met by the risk position for it to be exempted from the own funds requirements for foreign exchange risk. To be noted that, these requirements also fulfil the mandate for the EBA in Article 104c(4)(c) CRR.

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

71. For the purpose of assessing such requirements, institutions must provide supervisors with the business strategy used for the management of structural FX positions. In particular, the waiver application should refer to those documents in which the institution describes the intention and the strategy to hedge the capital ratio. This will be first and foremost the institution's risk appetite framework (RAF), although other relevant documents approved by the board or senior management of the institution could also be considered. In particular, the institution should include in the waiver application only elements that are reflected in (or are consistent with) the institution's general risk management strategy.

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

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

(i) the definition of the objective of the institution leading to the reduction of the sensitivity of the capital ratio to movements in the relevant exchange rate;

(ii) the strategy to achieve that objective[6], which should be outlined in a detailed, credible and reliable way, and the time horizon of this strategy, which should be at least 6 months.

74. It is worth highlighting that, for the purpose of receiving the structural FX waiver, the institution is not requested to fully offset the sensitivity of the ratio to changes in the exchange rate (as not explicitly stated also in the CRR3 text). It is fully acknowledged that institutions may have strategies that are, for example, based on a trade-off between having the ratio fully hedged (i.e. the sensitivity of the ratio to exchange rate changes is equal to zero) and zero volatility in CET1 due to the FX changes (i.e. according to the CRR this is equivalent to a net open position equal to zero).

75. The RTS allow institutions to set its objective with respect to the risk management of the structural positions. That objective must be based on quantitative criteria that are specific and detailed.

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

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

78. First, the risk management strategy must outline the definition of the boundaries between positions that the institution categorises as structural and taken with the purpose of hedging the ratio and those that are not structural. Those are also the boundaries that must be followed by the institution when categorising FX positions when entering into a new transaction bearing FX risk.

79. In addition, for the purpose of assessing whether the open structural position has been taken to hedge the ratio or not, the risk management strategy must outline how the institution plans

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

to meet in a continuous manner the objective that the institution has set. In particular, it must cover at least the following aspects:

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

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

(i) The intention to close/open the positions identified in point (a) should not lead to any inconsistency with the overall risk management strategy of the institution. In addition, it should not lead to any inconsistency with risk management that the legal entities within the group may have in place, e.g. at the solo level.

(ii) The intention to close/open the positions identified in point (a) should be consistent with the risk management strategies of the structural FX positions that legal entities (i.e. the parent bank/subsidiary) within the same group may have when applying the structural FX provision at a different level (i.e. on a solo/consolidated basis). In other words, closing/opening such positions, e.g. for the purpose of hedging the ratio at a consolidated level, must be compatible with the risk management strategy that the institution has for hedging the solo ratio.

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

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

82. The RTS also include requirements to ensure that the institutions can meet this objective under stressed circumstances, e.g. when a currency becomes particularly illiquidity as a result of restrictive measures (commonly known as sanctions) of the Union targeting a country.

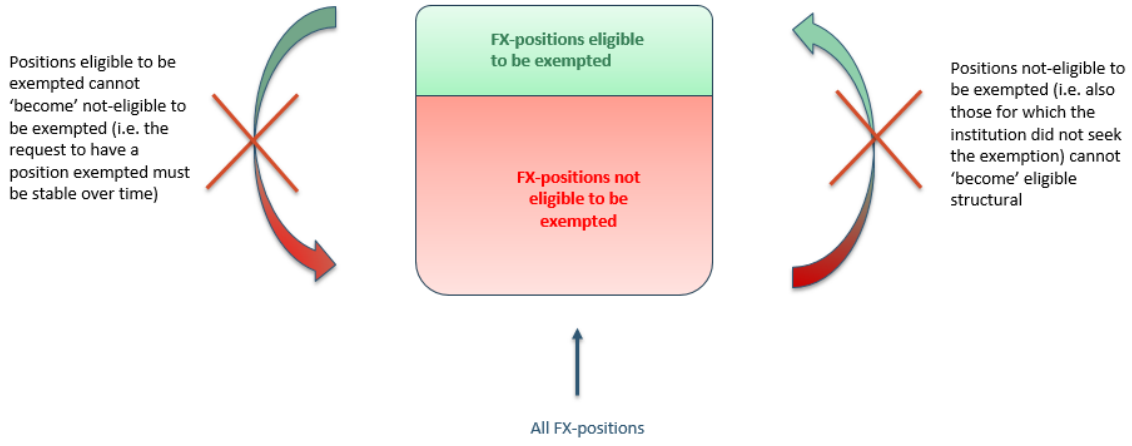
Exclusionary treatment of the hedge

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

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

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

Figure 1



Monitoring and reporting requirements

86. As usual, the approval of the competent authorities encompasses all specifications that the institution implements for meeting the requirements included in the previous sections (including those related to data that are used for computing the maximum open positions). Accordingly,

the approval of the competent authority holds only under the condition that such specifications remain unchanged.

87. As part of the requirements relating to the risk-management framework, the RTS include several measures that institutions are to monitor.

88. As soon as the institution plans to undertake any change to the specifications that are at the basis of an approval, it should inform the competent authority of the change (see Article 104c(3) CRR). Accordingly, the competent authority should assess the change and, in proportion to the relevance/importance of the change, should/may take any supervisory measure it deems appropriate (e.g. withdrawal of the previously granted permission).

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

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

- The competent authority could withdraw the permission that was previously granted if the institution is not able to put in practice the strategy described in the application waiver (i.e. the strategy that was at the basis of the permission). Alternatively, the institution may propose a change to the strategy included in the application waiver that it is actually able to implement. Such a change should be treated as outlined in paragraph 88.

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

91. As set out in Article 104c(1)(c) CRR3, the time horizon of the institution's strategy should be at least 6 months, meaning that the institution should not change e.g. the objective within a 6-month period from when the permission was granted. If after this period the institution wants to change the objective included in the strategy, for example due to a change in the business model, then it should be treated as a change to which the provisions in paragraph 88 apply.

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

3.3 Calculation of the maximum net open position

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

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

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

96. As mentioned, in the content of these RTS hedging the capital ratio to FX changes is interpreted as reducing the capital ratio sensitivity to a change in the FX rate.

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

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

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

- applies only to the currency for which the institution is calculating the maximum open position; i.e. the $FX - OFR$ for all other currencies should be included in the ratio used for the calculation of the maximum open position;

- avoids the circular effect of calculating the open position neutralising the ratio, including also the $FX - OFR$ of positions that will be excluded as part of the waiver.

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

- for institutions using the (either simplified or alternative) standardised approach for FX risk, this would simply require the institution to remove all positions in the currency for which the exemption is sought from the calculation of the net open position;

- for institutions using the internal model approach for FX risk, this would require institutions to run the value-at-risk model without considering changes in the relevant exchange rate.

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

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

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

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

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

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

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

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

(i) calculate the amount using formula $(*)$, substituting the Common equity tier 1 in formula $(*)$ with the Tier 1 capital (resp. the Total capital).

(ii) deduct from the amount obtained in (i) the delta equivalent of additional Tier 1 instruments (or the sum of the Additional Tier 1 (AT1) and Tier 2 (T2) instruments) issued in the structural currency.

103. It is important to highlight that any tax effect must not be considered when computing the maximum open position.

104. Annex I presents the derivation of formula (*).

Potential simplifications to the formulae

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

(i) institutions are able to show the effect of such simplifications on the value taken by the maximum open position;

(ii) the simplifications do not lead to an overestimation of the maximum open position.

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

106. The RTS complement that option by giving the possibility to institutions to simplify the formulae provided by considering only credit risk RWA, upon the condition that these RWA are the most material in the foreign currency. Such simplification, being prescribed, would not require institutions to do any gap analysis. As part of the consultation to these RTS, the EBA seeks feedback on the potential removal of one of the two simplifications (i.e. either remove the possibility referred to in the previous paragraph, or that referred to in this paragraph).

3.4 Exclusion of the risk position from the calculation of the FX-own funds requirements

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

(i) where the size of the open position suitable for the exemption (i.e. the open position generated by the FX positions suitable for the exemption) is lower than the maximum open position;

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

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

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

Example:

Consider the following 'simplified balance sheet' of an institution:

	Value in EUR		Value in EUR
Assets in EUR (BB[7])	500	Liabilities in EUR (BB)	400
Assets in USD (BB)	300	Liabilities in USD (BB)	250
		CET1 in EUR	150

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

110. It should be noted that, where the permission referred to in Article 325b to offset positions in the calculation of the market risk own funds requirements has been granted partially/not granted at all, banks may have a capital benefit that is greater than the maximum net open position[8].

111. Institutions should inform the competent authority of the positions that are actually excluded from the net open position. In particular, in the case of over-hedges, since only a part

[7] Banking book

[8] For example, consider the case a group made by parent bank and subsidiary, and assume that there is no 325b permission. Assume that the parent bank has a long position in USD of 100 EUR, and the subsidiary a short position in USD of 80 EUR. Without permission, the long and short position cannot be netted. Assume that the two positions meet all requirements in the RTS, and that the maximum net open position that can be removed is 15. The group, as a result of the permission, could remove 95 EUR from the parent bank, and 80 EUR from the subsidiary. De-facto what remains to be capitalised is a 5 EUR long position at parent bank level. Hence, the capital benefits (95 + 80 that could not be netted were removed) are higher than the maximum net open position (15).

of the positions can be actually waived, the institution should provide the competent authority with the criteria the institution uses for selecting the positions that are actually excluded.

112. Institutions using the simplified standardised approach are to exclude the positions from the calculation of the net open position in the foreign currency referred to in Article 352(1) CRR. Institutions using the standardised approach are to exclude the positions from the calculation of the unweighted delta sensitivity. Institutions using the internal model approach are to remove positions from the relevant tests (i.e. P&L attribution test and back-testing), as well as from the calculation of the expected shortfall measure and the stress scenario risk measure.

3.5 Specific provisions on non-monetary items at historical cost and items leading to gain or losses not affecting the CET1

113. The RTS on FX and Commodity risk in the banking book, clarifies that non-monetary items at historical costs are to captured as part of the FX charge.

114. In accordance with accounting standard IAS 21, monetary items refer to assets/liabilities with a right to receive or an obligation to deliver a fixed or determinable amount of money. For all these items, regardless of whether they are reflected at historical cost or at fair value, the FX rate applied must be that of the reporting date[9]. Non-monetary items (i.e. items with the absence of a right to receive or an obligation to deliver a fixed or determinable amount of money) should be translated using the exchange rate at the date of the transaction, unless they are designated at fair value, either applying the fair-value option or if they are held with trading intent. For a typical institution, participations in subsidiaries[10] in the individual balance sheet as well as real estate items would be such non-monetary items.

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

116. The RTS therefore set out that non-monetary items held at historical cost can be waived, as long as they are structural in nature, in excess to the maximum position that is calculated in

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

[10] To be noted that if the investment in the subsidiary is deducted from CET1, then automatically the item is not subject to the FX risk charge (as per FRTB standards and CRR requirements)

accordance with section 3.3. In other words, the cap calculated in accordance with that section does not apply to non-monetary items at historical cost.

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

3.6 Reporting on structural foreign exchange positions

118. In addition to the RTS, setting out the policy framework for the treatment of S-FX position, this consultation paper also presents a proposal for the reporting on S-FX permissions granted by competent authorities.

119. The reporting template and instructions (see Annexes III and IV to this consultation paper) have been developed based on current reporting requirements put in place by some competent authorities based on the reporting requirements specified in the Guidelines on structural FX. The reporting requirement has been adapted to the content of the RTS.

120. The vast majority of the information included in the template refers to items that the RTS request institutions to monitor, once a permission has been granted (see Article 8 of the RTS) or that the institution has to specify in its application for the S-FX permission (e.g. capital ratio hedged). For the sake of a comprehensive overview over the currency in question, this information is complemented by information on positions that cannot be considered structural (e.g. trading book positions). Information has to be provided for every currency, for which an S-FX permission was granted.

121. The information included in the template should be provided by any institution that has obtained an S-FX permission, irrespective of the approach for calculating own funds requirements for foreign exchange risk applied. It would be reported with a quarterly frequency, alongside the remainder of the reporting on own funds and own funds requirements through COREP.

122. As the remainder of COREP, the reporting requirement will be included in the ITS on Supervisory Reporting (Regulation (EU) 2021/451). Later this year, the EBA will publish a consultation paper on the second wave of CRR3-driven and other-amendments to the reporting framework ('Step 2' of the amendments to the reporting, see paragraph 24 of the EBA Roadmap for strengthening the prudential framework). In principle, the S-FX reporting will form part of that second wave of reporting requirements to be implemented, targeting an application date in early 2026 (framework release v4.1). Given the close link to the policy framework,

the proposal for the reporting on S-FX is already presented here, but will be finalised as part of the aforementioned proposal on 'Step 2' of the amendments to reporting.

4. Draft Regulatory Technical Standards

COMMISSION DELEGATED REGULATION (EU) …/…

of XXX

supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards specifying requirements on foreign exchange risk hedges of capital ratios in accordance with Article 104c

(Text with EEA relevance)

THE EUROPEAN COMMISSION,

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

Having regard to Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and amending Regulation (EU) No 648/2012[11], and in particular Article 104c(4), third subparagraph thereof,

Whereas:

(1) Hedging the capital ratio against adverse movements of an exchange rate is meaningful only in the context of currencies against which the institution has a significant exposure. Accordingly, a risk position should be considered to be taken or maintained for the purpose of hedging this ratio only where the business of the institution in the currency is significant. To ensure a harmonised treatment across the Union, quantitative criteria should determine whether a currency is to be considered material or not.

(2) A risk position that the institution has taken or maintains for the purpose of hedging a capital ratio from adverse movements of an exchange rate should fulfil its hedging goals. Accordingly, requirements aiming at assessing whether the risk position effectively hedges the capital ratios should be envisaged.

(3) Considering that only net long risk position can act as a hedge of the capital ratio, net short risk position should not be recognised as a hedge for this purpose. Furthermore, considering that the hedging effects of a position are not affected by whether the institution has received the permission referred to in Article 325b of Regulation (EU) No 575/2013, all positions constituting the risk position should be offset for the purpose of assessing the effects of the hedge even when that permission has not been granted.

(4) Internal trades between trading book and non-trading book cannot hedge the capital ratio to movements in the foreign exchange rate. For that reason, they should not be excluded from the own funds requirements for foreign-exchange as part of the permission referred to in Article 104c of Regulation (EU) No 575/2013.

[11] OJ L 176, 27.6.2013, p. 1.

(5) Capital ratio management, including managing the capital ratio's sensitivity towards exchange rates is not a trading related business. Accordingly, risk positions that are taken or maintained to hedge the ratio should be non-trading book positions of a structural nature. To ensure alignment with international standards, non-trading book positions that are of a structural nature should include, but should not be a priori limited to, those that attract foreign exchange risk in the form of translation risk.

(6) To ensure level playing field across institutions in the Union, the foreign exchange risk hedge neutralising the sensitivity of the capital ratios to adverse movements in foreign exchange rates should be determined based on a standardised formulae. However, to reduce operational burden, this Regulation should allow simplifications in the formulae provided while ensuring a prudent outcome.

(7) Requirements on the exclusion of the risk position from the own funds requirements for foreign exchange risk should ensure that the portion of risk position in excess of that neutralising the sensitivity of the capital ratio to movements in the foreign exchange rate is not excluded from the own funds requirements for foreign exchange risk. For internal models, the exclusion of positions should be done consistently in the context of the back-testing requirements, the profit and loss attribution requirements, and the calculation of the expected shortfall and stress scenario risk measures.

(8) Given the particular features of items for which the institution does not update the value to reflect changes in the exchange rate as referred to in Article 1(5) and Article 3(6) of Commission Delegated Regulation (EU) 2023/1577, this Regulation should prescribe how those items should be treated. For completeness, this should be done for both the determination of the position neutralising the sensitivity of the capital ratio to movements in the foreign exchange rate and the exclusion of that position from the own funds requirements for foreign exchange risk. Similarly, this Regulation should prescribe the treatment applicable to items that may lead to gain or losses due to movements in the exchange rate that do not impact the CET1 capital.

(9) Given the primary role that the risk management framework has in the context of the permission referred to in Article 104c of Regulation (EU) No 575/2013, its requirements should be designed to ensure that the institution's strategy is detailed enough to be assessed against both quantitative and qualitative criteria. Furthermore, they should ensure that the institution's strategy can be objectively implemented.

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

(11) The European Banking Authority 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 advice of the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093/2010 of the European Parliament and of the Council[12].

[12] Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (OJ L 331, 15.12.2010, p. 12–47. ELI: http://data.europa.eu/eli/reg/2010/1093/oj).

HAS ADOPTED THIS REGULATION:

Article 1

Definition of overall risk position

For the purpose of this Regulation, the overall risk position resulting from a set of positions in a foreign currency shall either be:

(a) the net unweighted delta sensitivity corresponding to those position towards the risk factor made of the exchange rate between the reporting currency and the foreign currency; or,

(b) the net open position in the foreign currency as resulting from the application of Article 352 of (EU) Regulation No 575/2013.

Box for consultation

Under CRR, banks will have the possibility to use two standardised approaches for computing the own funds requirements for market risk. One approach, namely, the simplified standardised approach, relies on the calculation of a net open position in accordance with Article 352 CRR. Instead, the FRTB standardised approach relies on the computation of sensitivities. While the two approaches are expected to lead to the same result (i.e. the delta sensitivity towards the FX risk factor is de-facto equivalent to the net open position computed in accordance with Article 352), the RTS include this provision setting out the meaning of "overall risk position" in the context of both approaches to ensure a sound application of the S-FX provision.

Question for consultation

Q1. Do you agree with the clarification provided in Article 1 of these proposed RTS?

SECTION 1

RISK POSITIONS THAT AN INSTITUTION CAN DELIBERATELY TAKE TO HEDGE, AT LEAST PARTIALLY, AGAINST THE ADVERSE MOVEMENTS OF FOREIGN EXCHANGE RATES ON ANY OF ITS CAPITAL RATIOS REFERRED TO IN ARTICLE 92(1), POINTS (a), (b), AND (c) OF REGULATION (EU) NO 575/2013

Article 2

Conditions for a risk position to be considered a position that an institution deliberately takes in order to hedge its capital ratio

1. An overall risk position resulting from a set of risk positions in a foreign currency, in relation to which an institution applies for the permission referred to in Article 104c of Regulation (EU) No 575/2013, shall be considered a risk position deliberately taken in order to hedge, at least partially, against the adverse movements of foreign exchange rates on any of its capital ratios referred to in Article 92(1), points (a), (b) and (c) of that Regulation where all the following conditions are met:

(a) It is in a currency that is significant for the institution in accordance with Article 3;

(b) It hedges the ratio in accordance with Article 4;

(c) It is structural in accordance with Article 5;

(d) It is managed in accordance with the risk management framework meeting the requirements referred to in Article 8.

2. For the purposes of this Regulation, institutions that use a base currency to compute the own funds requirements for foreign exchange risk in accordance with Article 325q(7) of Regulation (EU) No 575/2013 shall treat that base currency as the reporting currency, and the reporting currency as a foreign currency.

Article 3

Significant currencies for an institution

A currency shall be considered as significant where any of the following conditions is met:

(a) The currency is one of the ten foreign currencies for which the total credit risk weighted amounts in the institution are the largest;

(b) The ratio of the total credit risk weighted amounts in the currency to the total credit risk weighted amounts in all currencies other than the reporting currency is equal to or higher than 1%.

Box for consultation

Under the GLs on structural FX, institutions and competent authorities are required to apply the structural FX provision only in the context of those currencies that are relevant for the business of institution (see paragraph 18-20 of the Guidelines). However, the guidelines did not introduce a methodology to identify those currencies.

Based on the supervisory feedback received by the EBA, it appears that the application of the provision diverges from one institution to another. Hence, in view of harmonising its application, and on the basis of the data provided by the institutions to competent authorities as part of the monitoring requirements referred to in Section 9 of the guidelines, the RTS proposed for consultation introduce the quantitative criteria set out in Article 3.

This quantitative criterion is based on the credit risk risk-weighted assets for foreign currency items. This was done considering that (i) the application of the structural FX provision relates to non-trading book items, and (ii) the sensitivity to FX changes of the denominator of the capital ratio is mostly driven by credit risk risk-weighted assets.

Question for consultation

Q2. Do you agree with the criteria to identify the significant currencies for an institution? Do you agree with a threshold set at 1% or do you deem that a higher threshold (e.g. 2%) would create more level playing field across institutions? If not, what would be alternative criteria? Please elaborate.

Article 4

Requirements relating to the hedging effects

1. An overall risk position in a foreign currency shall be considered to be hedging the capital ratio where all the following conditions are met:

   (a) The overall risk position reduces the adverse effect on that ratio caused by changes in the exchange rate, irrespective of whether that adverse effect derives from an appreciation or a depreciation of that foreign currency with respect to the reporting currency and irrespective of whether the position is maintained for hedging the ratio or taken for hedging the ratio;

   (b) When the foreign currency of the overall risk position appreciates against the reporting currency, the numerator of the ratio increases;

   (c) The overall risk position is net long;

   (d) The overall risk position is a delta risk position;

   (e) The overall risk position does not include positions resulting from internal trades between the trading book and non-trading book business of the institution;

   (f) Where the institution computes the own funds requirements of Regulation (EU) No 575/2013 for market risk on a consolidated basis without having the permission referred to in Article 325b(2) of Regulation (EU) No 575/2013, and the overall risk position is made by risk positions that are net short at the level of one or more of the institutions within the group, those risk positions in those institutions are managed exclusively with the objective of hedging the consolidated level ratio;

   (g) Where the institution computes the own funds requirements of Regulation (EU) No 575/2013 for market risk on a consolidated basis having the permission referred to in Article 325b of Regulation (EU) No 575/2013, and the overall risk position is made of risk positions that are net short at the level of either any subsets of institutions in the group within which the positions are offset as specified in that permission, or at the level of any other of the institutions within the group which are not included in that permission, those risk positions in those subsets of institutions or in the other institutions outside the permission are managed exclusively with the objective of hedging the consolidated level ratio.

2. On a consolidated basis, where the overall risk position is made of risk positions booked in more than one institution of the group, the requirement referred to in paragraph 1, point (c), shall be assessed by netting all those positions regardless of whether the institution has the permission referred to in Article 325b of Regulation (EU) No 575/2013.

Box for consultation

Positions that are taken or that are maintained to hedge the ratio should have hedging effects. Considering that internal trades between banking book and trading book do not have any hedging effects, they should not be part of any exemption. In other words, it cannot be argued

that an internal trade was performed with the purpose of hedging the ratio. Accordingly, the requirement in paragraph 1(e) has been added to clarify this aspect.

This requirement should also act a safeguard against cases where the institution seeks to transfer risk from the trading book to the banking book, solely for the purpose of meeting the requirement referred to in Article 4, i.e. the requirement that only banking book positions can be part of the structural FX waiver.

Question for consultation

Q3. Do you agree that internal trades cannot be considered as taken for hedging the ratio? Please elaborate.

Article 5

Structural nature of the risk position

A risk position shall be considered structural when it is made exclusively of one or more of the following categories of risk positions:

(a) on an individual basis, non-trading book risk positions that correspond to investments in institutions that are included in the same scope of consolidation;

(b) on a consolidated basis, non-trading book risk positions that stem from investments in an institution that is included in the scope of consolidation and are in the reporting currency of the institution holding those positions;

(c) non-trading book risk positions that relate to the cross-border nature of the institution or to a well-established business of the institution which is stable over time.

Box for consultation

Similarly to the GLs, the RTS proposed for consultation include the possibility for positions that do not directly relate to an investment to be recognised as structural – see point (c) of Article 5. The EBA specifically seeks feedback on actual cases where the provision referred to in that point is, or may be, used.

Question for consultation

Q4. What do you think should be cases of positions potentially exempted under the provisions included in Article 5(c)? Please elaborate.

SECTION 2

DETERMINING THE AMOUNT NEUTRALISING THE SENSITIVITY OF THE CAPITAL RATIOS TO MOVEMENTS IN FOREIGN EXCHANGE RATES AND EXCLUSION OF THE RISK POSITION FROM THE OWN FUNDS REQUIREMENTS FOR FOREIGN EXCHANGE RISK

Article 6

Determination of the position neutralising the sensitivity to the capital ratio

1. The amount neutralising the sensitivity of the capital ratios to the adverse movements in foreign exchange rates shall be determined by summing:

   (a) The overall risk position relating to items that are structural in accordance with Article 5 and that meet either of the following conditions:

      (i) The item is subject to the treatment referred to in Articles 1(5) or 3(6) of Commission Delegated Regulation (EU) 2023/1577;

      (ii) The item leads to gains or losses due to changes in the exchange rate that do not impact the CET1 capital.

   (b) The maximum open position $MaxOP_{FC}$ calculated in accordance with paragraph 2.

2. The maximum open position $MaxOP_{FC}$ shall be calculated as follows:

   (a) where the institution aims at hedging the CET1 ratio, in accordance with the following formula:

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

   Where:

   - FC = the currency of the structural position;
   - $MaxOP_{FC}$ = the maximum open position expressed in the foreign currency FC;
   - $CET1$ = the Common Equity Tier 1 of the institution;
   - FX_{FC} = the spot exchange-rate between the reporting currency and the foreign currency FC of the structural position;
   - $RWA_{NoFX_{FC}}(.)$ = the total risk exposure amount expressed in the reporting currency calculated in accordance with Article 92(3) of Regulation (EU) No 575/2013, excluding the own funds requirements for foreign-exchange risk for all positions that are in the foreign currency FC;

   (b) where the institution aims at hedging the T1 ratio, in accordance with the following formula:

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

Where:

- FC = the currency of the structural position;
- $MaxOP_{FC}$ = the maximum open position expressed in the foreign currency;
- $T1$ = the Tier 1 Capital of the institution expressed in the reporting currency;
- FX_{FC} = the spot exchange-rate between the reporting currency and the foreign currency FC;
- $RWA_{NoFX_{FC}}(.)$ = the total risk exposure amount expressed in the reporting currency calculated in accordance with Article 92(3) of Regulation (EU) No 575/2013, excluding the own funds requirements for foreign-exchange risk for all positions that are in the foreign currency FC;
- $AT1_{FC}$ = the value derived in accordance with the following formula:

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

where:

- V = the value of the portfolio expressed in the reporting currency constituted by all Additional Tier 1 instruments issued by the institution;

1.

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

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

Where:

- OF = the own funds of the institution;
- $RWA_{NoFX_{FC}}(.)$ = the total risk exposure amount expressed in the reporting currency calculated in accordance with Article 92(3) of Regulation (EU) No 575/2013, excluding the own funds requirements for foreign-exchange risk for all positions that are in the foreign currency FC of the structural position;
- FX_{FC} = the spot exchange-rate between the reporting currency and the foreign currency FC of the structural position;
- $AT1_{FC}$ = the value derived in accordance with the following formula:

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

where:

- V_{AT1} = the value of the portfolio expressed in the reporting currency constituted by all Additional Tier 1 instruments issued by the institution;
- $T2_{FC}$ = the value derived in accordance with the following formula:

$$T2_{FC} = \frac{V_{T2}(1.01 \cdot FX_{FC}) - V_{T2}(FX_{FC})}{0.01 \cdot FX_{FC}}$$

where:

- V_{T2} = the value of the portfolio expressed in the reporting currency constituted by all tier 2 instruments issued by the institution.

3. By way of derogation from paragraph 2, and where the overall risk position in the foreign currency stemming from non-trading book items is at least 80% of the overall risk position in that currency including both non-trading book and trading book items, the institution may replace $RWA_{NoFX_{FC}}(.)$, with $RWA_{CR}(.)$, where:

   $RWA_{CR}(.)$ = where the institution TREA is equal to U-TREA as referred to in Article 92(3), the un-floored exposure amount expressed in the reporting currency referred to in Article 92(4), point (a) of Regulation (EU) No 575/2013;

   $RWA_{CR}(.)$ = where the institution TREA is equal to $72.5\% \cdot \mathrm{S} - \mathrm{TREA}$ as referred to in Article 92(3), $72{,}5\% \cdot$ the standardised exposure amount expressed in the reporting currency referred to in Article 92(5), point (a) of Regulation (EU) No 575/2013.

4. Institutions not using the treatment referred to in paragraph 3, may apply simplifications when calculating the maximum open position referred to in paragraph 2 where they meet both of the following conditions:

   (a) they are able to show the effect of such simplifications on the value of the maximum net open position;

   (b) the effect of the simplifications referred to in point (a) does not represent an overestimation of the maximum open position.

Box for consultation

The RTS include the possibility for banks to compute the maximum open position by considering credit risk RWA only (see paragraph 3), when the institution's non-trading book business in the foreign currency is more prominent than the trading book component.

Considering this additional possibility, it is the intention of the EBA to exclude the provision included in paragraph 4 (taken from the guidelines on S-FX) so to streamline the possibilities available to institutions.

Questions for consultation

Q5. Do you agree with the simplification allowing institutions to use only credit risk RWA in the determination of the MAX_OP? Please elaborate.

Q6. Do you expect that institutions currently using the derogation referred to in Article 6(4) would qualify for the treatment referred to in paragraph 3 of that Article? Please elaborate.

Article 7

Exclusion of the risk position from the own funds requirements for foreign-exchange risk

1. Institutions intending to exclude part of or the entire risk position from the own funds requirements for foreign exchange risk shall apply the following steps in sequence:

   (a) they shall exclude from the own funds requirements for foreign exchange risk all the risk positions corresponding to items referred to in Article 6(1), point (a);

   (b) Assess whether the remaining risk positions of which the overall risk position is made, following the application of point (a), lead to an overall risk position that is greater, equal or lower than the maximum open position $MaxOP_{FC}$ referred to in Article 6(1)(b) and classify the hedging technique as follows:

Remaining position Vs $MaxOP_{FC}$	**Hedging technique**
remaining position < $MaxOP_{FC}$	Under hedge
remaining position = $MaxOP_{FC}$	Perfect hedge
remaining position > $MaxOP_{FC}$	Over hedge

   (c) Where the institution is under-hedging or perfectly hedging its capital ratio, the institution shall exclude all remaining positions of which the overall risk position is made;

   (d) Where the institution is over-hedging its capital ratio, the institution shall exclude some of the remaining positions in a way that net position excluded equals the maximum open position ($MaxOP_{FC}$) referred to in Article 6.

   On a consolidated basis, when excluding positions in accordance with paragraph 1, point (d), and with the purpose of verifying that the excluded net position equals the maximum open position $MaxOP_{FC}$, an institution shall net positions between institutions of the group whose positions cannot be offset for the purpose of computing the own funds requirements for market risk in accordance with Article 325b of Regulation (EU) No 575/2013.

2. An institution applying the simplified standardised approach referred to in Article 325(1), point (c) of Regulation (EU) No 575/2013 for positions to be excluded in accordance with paragraph 1, shall exclude those positions from the calculation of the net open position in the foreign currency referred to in Article 352(1) of Regulation (EU) No 575/2013.

3. An institution applying the alternative standardised approach referred to in Article 325(1), point (a) of Regulation (EU) No 575/2013 for positions to be excluded in accordance with paragraph 1, shall exclude those positions from the calculation of the unweighted delta sensitivity referred to in Article 325f(3) of Regulation (EU) No 575/2013 towards the exchange rate between the reporting and the foreign currency.

4. An institution applying the alternative internal model approach referred to in Article 325(1), point (b) of Regulation (EU) No 575/2013 for positions to be exclude in accordance with paragraph 1, shall:

   (a) Exclude those positions from the actual, hypothetical and theoretical changes in the portfolio value referred to in Article 325bf and Article 325bg of Regulation (EU) No 575/2013;

   (b) Exclude those positions from the computation of the Value-at-Risk numbers referred to in Article 325bf of Regulation (EU) No 575/2013;

   (c) Exclude those positions from the calculation of the expected shortfall measures referred to in Article 325bb Regulation (EU) No 575/2013 and the stress scenario risk measure referred to in Article 325bk of that Regulation.

5. An institution using more than one of the approaches referred to in Article 325(1) of Regulation (EU) No 575/2013, shall apply paragraphs 2, 3 and 4 consistently with the approach used to calculate the own funds requirements for foreign exchange risk for the positions to be excluded.

SECTION 3

RISK-MANAGEMENT FRAMEWORK

Article 8

Criteria for an appropriate risk-management framework

1. A risk management framework shall be considered appropriate where all the following conditions are met:

   (a) it is documented adequately in accordance with paragraph 2 and it foresees that the capital ratio hedged is the same across all currencies for which the institution seeks the permission referred to in Article 104c of Regulation (EU) No 575/2013;

   (b) it sets out the objective to hedge the ratio from movements in the exchange rate over time and provides for its assessment by means of both quantitative measures and qualitative criteria;

   (c) it specifies a maximum acceptable level of tolerance for the sensitivity of the ratio with respect to changes in the exchanges rate and specifies in detail the criteria and methodology for setting such a level of tolerance. Criteria for setting the level of tolerance should encompass all components that may lead to a change in the value taken by the sensitivity and any specificity of the currency;

   (d) it includes a limit of the maximum loss that is deemed acceptable for the institution to incur due to the choice of maintaining the positions for which the permission referred to in Article 104c of Regulation (EU) No 575/2013 is sought;

   (e) it is approved by the management board of the institution, along with the documentation referred to in point (a);

(f) it is linked to the risk-appetite framework of the institution and the overall risk management of the institution and any relevant documents that have been approved by the senior management or the board of the institution;

(g) it includes an explicit warning that the open position that is maintained for hedging the ratio will lead to losses as soon as the relevant currency depreciates, and that hedging the ratio leads to an increase in the volatility of the own funds due to changes in the relevant exchange rate;

(h) it specifies a strategy that has a time horizon of at least six months to achieve the objective referred to in point (b) which includes at least the following:

(i) it outlines the definition of the boundaries between positions that the institution categorises as taken with the purpose of hedging the ratio and those that are not, and requires that such boundaries are used by the institution when taking a new position in the relevant currency;

(ii) it states the positions the institution intends to open or close for the purpose of meeting the objective referred to in point (b);

(iii) it requires the documentation of evidence for both of the following:

i. that opening or closing those positions does not lead to any inconsistency with the overall risk management of the institution or with the risk management that any entity within the scope of the consolidation may apply on an individual basis;

ii. that opening or closing those positions is consistent with the risk management frameworks that any entity within the scope of consolidation may have where applying the provision in Article 104c of Regulation (EU) No 575/2013 for the purpose of hedging ratios at another level of consolidation;

(i) it ensures that the institution can identify, at any time, the items corresponding to positions taken with the purpose of hedging the ratio;

(j) it provides evidence, where applicable based on past experience, that the strategy referred to in point (h) is implementable and the objective achievable, including where there are significant divergencies in the offshore and onshore markets of the foreign currency;

(k) where applicable, it describes how positions that have been taken with the only purpose of hedging the ratio in accordance with Article 4(1), point (f) and point (g) are managed in order to meet the objective referred to in point (b);

(l) It ensures that the exclusion of the risk position fulfils the requirements set out in Article 7, and that such an exclusion does not reduce vega risk and curvature risk;

(m) It envisages the monitoring of the following measures, at least on a monthly basis;

(i) the overall risk position in the currency previous to any permission;

(ii) the overall risk position meeting the requirements referred to in Article 2(1);

(iii) the overall risk position relating to items referred to in Article 6(1), point (a);

(iv) the overall risk position meeting the requirements referred to in Article 1(1) excluding items referred to in Article 6(1), point (a) (hereinafter referred to as "S_OP");

(v) the maximum open position $MaxOP_{FC}$ referred to in Article 6(1)(b);

(vi) both of the following sensitivities:

i. $sensitivity_1 = \frac{S\_OP - MaxOP_{FC}}{RWA_{NoFX_{FC}}}$

Where:

- S_OP as defined in point (iv)
- $MaxOP_{FC}$ = the maximum open position referred to in Article 6(1)(b);
- FC the currency of the risk position;
- $RWA_{NoFX_{FC}}$ = the total risk exposure amount calculated in accordance with article 92(3) of Regulation (EU) No 575/2013, excluding the own funds requirements for foreign-exchange risk for all positions that are in the foreign currency FC

ii. the sensitivity of the capital ratio with respect to changes in the exchange rate as calculated by the institution;

(vii) The difference in own funds requirements for market risk following the exclusion of the risk position in accordance with Article 7.

(viii) a qualitative assessment stating the reasons for any changes in the amount of the overall risk position referred to in point (iii) and point (iv) and the values taken by the two sensitivities referred to in point (vi);

(ix) the spot exchange rate between the reporting currency and the foreign currency FC on the reference date;

(x) any planned changes relating to the request to the competent authority;

(xi) the percentage of total credit risk-weighted amounts in the foreign currency to the total risk-weighted amounts of the institution;

(xii) the percentage of total credit risk-weighted amounts in the foreign currency to the total credit risk weighted amounts in all currencies other than the reporting currency;

On a consolidated basis, for the purposes of determining the overall risk position referred to in points (i) to (iv), institutions shall offset positions within the group regardless of whether the institution has the permission referred to in Article 325b of Regulation (EU) No 575/2013.

2. The risk management framework shall be considered adequately documented in accordance with paragraph 1, point (a), where all the following conditions are met:

   (a) The documentation describes which positions are excluded pursuant to Article 6 of this Regulation;

   (b) All the conditions laid down in paragraph 1, points (b) to (m) are documented;

   (c) The documentation outlines the data and capital figures that are used for computing the quantitative measures referred to in paragraph 1, point (m);

   (d) Where the institution took some positions with the sole purpose of hedging the ratio in accordance with Article 3(1), point (f) and point (g), the documentation includes evidence that those positions were taken with that purpose only;

   (e) Where applicable, the documentation describes the simplifications that are made for the purpose of computing the maximum net open position and the analysis of the effect of such simplifications on the value taken by that maximum net open position in accordance with Article 5(4), by providing at least a gap analysis showing that the simplifications made do not lead to an overestimation of the maximum net open position.

3. For the purposes of paragraph 1, point (j), the institution shall duly take into account:

   (a) The liquidity of the currency. In doing so, the institution shall prove, for illiquid currencies, that the illiquidity does not impair the actual implementation of the strategy;

   (b) Significant volatility in the exchange rate. In doing so, the institution shall prove that fast changes in the relevant exchange rate do not impair the actual implementation of the strategy;

   (c) The presence of restrictive measures targeting a country that may impact a currency tradability. In doing so, the institution shall prove that those restrictive measures do not impair the actual implementation of the strategy.

Box for consultation

The requirements relating to the risk-management framework represents an important pillar of the Structural-FX provision, as they are used as a basis to assess the intention of the institution to hedge the ratio – a prerequisite to obtain the approval to exclude the positions from the own funds requirements for foreign exchange risk. The requirements presented for consultation are based on those set out in the context of the Structural FX guidelines.

The restrictive measures taken by the Union on Russia rendered the tradability of the Ruble more difficult for banks in the Union. This resulted in the inability for some banks to follow

the capital ratio hedging strategy in the context of that currency. In light of this, it is considered appropriate to introduce additional safeguards in the RTS (when compared to the Guidelines) to address those or similar scenarios.

Question for consultation

Q7. Do you agree with the requirements set out in Article 7(1)(j), and in Article 7(3)? Do you see the need to introduce additional safeguards to address, for example, currency crisis? Please elaborate.

Please note that additional questions (on reporting) have been included in the reporting instructions that can be found in Annex IV to this package. All questions have been consolidated in section 5.2 (Overview of questions for consultation).

SECTION 4

Final provisions

Article 9

Entry into force and application

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

[Position]

5. Accompanying documents

5.1 Draft cost-benefit analysis / impact assessment

Article 104c of the CRR3 requires the EBA to develop draft RTS to specify: i) the risk positions that an institution can deliberately take in order to hedge, at least partially, against the adverse movements of foreign exchange rates on any of an institution's capital ratios; ii) how to determine the maximum amount of the risk position that is excluded from the own funds requirements for market risk and the manner in which an institution shall exclude this amount for each of the approaches set out in Article 325(1) CRR; and iii) the criteria that shall be met by an institution's risk management framework for hedging the adverse movements in foreign exchange rates on any of its capital ratios, in order to be considered appropriate for the purpose of this Article.

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 provisions included in the RTS. The analysis provides an overview of identified problems, the proposed options to address those problems and the costs and benefits of those options. Given the nature and the scope of the RTS, the IA is high-level and qualitative in nature.

A. Problem identification

Article 352(2) of the CRR2 allows competent authorities to permit, on an ad hoc basis, the exclusion of FX risk positions from the calculation of net open currency positions where an institution has deliberately taken these positions to hedge against adverse effects of the exchange rates on its capital ratios. However, this provision has been subject to several interpretations, leading to differences in its application across the EU. In order to ensure a harmonised approach, the EBA has produced in 2020 own-initiative guidelines on the practical implementation of the 'structural FX' provision.

CRR3 replaces Article 352(2) of the CRR2 with Article 104c, providing the EBA with a legal mandate on how to treat foreign exchange risk hedges of capital ratios. This requires the EBA to review and replace the GL on 'structural FX' with an RTS in order to be aligned with CRR3.

B. Policy objectives

The objective of these draft guidelines is to provide for a harmonised approach to the practical implementation of the provision contemplated in Article 104c of the CRR3. In this way, the guidelines aim to ensure a level playing field and promote convergence of supervisory practices across the EU regarding the treatment of foreign exchange risk hedges of capital ratios.

C. Baseline scenario

The baseline scenario aims to describe the regulatory environment and regulatory developments, as well the institutions' practices.

In terms of regulatory environment, the baseline assumes the entry into force of the CRR3. It is also expected that institutions are compliant with the existing GL on structural FX.

D. Options considered, Cost-Benefit Analysis and Preferred Options

This section presents the main policy options discussed during the development of the RTS, the costs and benefits of these options, as well as the preferred options included in the RTS.

Alignment with existing GL on structural FX

Option 1a: Align the RTS and the ITS on reporting with the existing GL on structural FX

Option 1b: Do not align the RTS with the existing GL on structural FX

Option 1a takes into account that several institutions have already implemented the GL on structural FX and ensures regulatory stability in the framework. Under this option, banks would not need to make significant changes in their existing implementation but rather very limited ones to align with the few changes made in these RTS. The same holds true for the reporting part of the package (i.e. the ITS) given that the GLs already foresaw monitoring requirements involving the calculation of monthly figures which were expected to be reported, outside COREP, to the competent authority.
In addition, this option reduces the burden on supervisors as they will need to focus only on those aspects that were amended in the RTS to ensure compliance with the new structural FX provision for banks already granted the permission under Article 352(2) of CRR2.

In contrast, Option 1b will require banks to implement new regulatory requirements and possibly undo changes already implemented, causing additional compliance costs. Supervisors would also need to re-assess compliance with the new structural FX provision for approvals that were already granted under the provisions set out in the GLs.

Given that the existing GL have already been developed after an extensive consultation with the industry, it would be counterproductive and disproportionate to repeat the same process. Moreover, it should be noted that, the GL were developed with the FRTB standards published by the BCBS in January 2019 in mind, and hence are aligned with the market risk framework under the CRR3.

Hence, option 1a is preferred.

Significant currencies for an institution

Option 2a: Apply quantitative conditions to identify significant currencies

Option 2b: Apply quantitative and qualitative conditions to identify significant currencies

Under option 2a, only quantitative conditions will be considered to identify significant currencies. This ensures a full harmonisation on the way significant currencies are identified across banks in the EU. To capture all the currencies that are material for the bank, both an absolute and a relative threshold is considered. This allows banks performing business in several countries with different currencies to capture all their significant currencies (even those that fall above the absolute threshold).

Under Option 2b, both quantitative and qualitative conditions are considered. Under this option, currencies that do not meet the quantitative conditions may still be considered significant based on additional qualitative considerations. This option does not ensure a level playing field within the EU and may lead banks to request the permission for currencies that are not actually material for their business.

Option 2a is preferred.

5.2 Overview of questions for consultation

Questions relating to the draft RTS

Q1. Do you agree with the clarification provided in Article 1 of these proposed RTS?

Q2. Do you agree with the criteria to identify the significant currencies for an institution? Do you agree with a threshold set at 1% or do you deem that a higher threshold (e.g. 2%) would create more level playing field across institutions If not, what would be alternative criteria? Please elaborate.

Q3. Do you agree that internal trades cannot be considered as taken for hedging the ratio? Please elaborate.

Q4. What do you think should be cases of positions potentially exempted under the provisions included in Article 5(c)? Please elaborate.

Q5. Do you agree with the simplification allowing institutions to use only credit risk RWA in the determination of the MAX_OP? Please elaborate.

Q6. Do you expect that institutions currently using the derogation referred to in Article 6(4) would qualify for the treatment referred to in paragraph 3 of that Article? Please elaborate.

Q7. Do you agree with the requirements set out in Article 7(1)(j), and in Article 7(3)? Do you see the need to introduce additional safeguards to address, for example, currency crisis? Please elaborate.

Questions relating to the reporting ITS

Q8. Did you identify any issues regarding the representation of the RTS policy framework for S-FX in the ITS reporting requirement?

Q9. Are the scope of application of the reporting requirements, the template itself and instructions clear?

Q10. Does the reporting of the net reduction in own funds requirements (c0130) by currency, or any other element of the reporting requirement, trigger a particularly high, or in your view disproportionate, effort or cost of compliance? If yes, please explain the trigger/source of the cost and offer suggestions on alternative ways to achieve the same/a similar result with lower cost of compliance.

Annex I: Derivation of the maximum open position

Derivation of the formulas for an institution hedging the CET1 ratio

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

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

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

where:

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

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

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

$$\mathrm{CET1}(FX_{FC}) = \sum_{j=0}^{\infty} C_j \cdot \left(FX_{FC} - FX_{FC_0}\right)^j$$
$$= C_0 + C_1 \cdot \left(FX_{FC} - FX_{FC_0}\right) + \sum_{j=2}^{\infty} C_j \cdot \left(FX_{FC} - FX_{FC_0}\right)^j \quad (2)$$

where:

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

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

(iii) the coefficients C_j are not dependent on FX_{FC}.

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

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

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

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

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

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

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

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

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

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

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

where:

- OP_{CET1} is the resulting net open position stemming from items that lead to gains or losses that can be reflected in the $CET1$;
- OP_{ExCET1} is the resulting net open position stemming from items that lead to gains or losses that cannot be reflected in the $CET1$[13].

[13] There may be cases of items that are included in the net open position but whose gains or losses cannot be reflected in CET1, as noted by some respondents during the consultation on the EBA guidelines that have been used as a basis to produce these RTS.

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

Combining that:

a. $C_1^{Optimal}$ is the value of C_1 for which the sensitivity of the ratio with respect to changes in the relevant exchange rate is equal to zero;

b. $C_1 \cong OP_{CET1}$ following the reasoning in the previous paragraph;

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

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

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

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

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

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

In addition, considering that FX positions stemming from items whose gains or losses cannot be reflected in the CET1 capital, which, in any case, have been included in the calculation of the net open position (i.e. those included in the calculation of OP_{ExCET1}), do not affect the way the $CET1$ moves with respect to FX changes, they can be excluded from the net open position regardless of the cap imposed in $(*)$.

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

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

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

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

The sensitivity in (9) can be written as:

$$\frac{\partial CR_{MaxOp}}{\partial FX_{FC}} = \frac{S\_OP_{CET1} + NS\_OP_{CET1} - MaxOP}{RWA_{NoFX_{FC}}} \quad (10)$$

where:

a) S_OP_{CET1} is the resulting open position stemming from items whose gains and losses can be reflected in the $CET1$ and corresponding to positions that are suitable to be exempted.

b) NS_OP_{CET1} is the resulting open position stemming from items whose gains and losses cannot be reflected in the $CET1$ and corresponding to positions that are not suitable to be exempted.

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

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

Derivation of the formulas for an institution hedging the T1 ratio

The reasoning below is presented in the context of an institution applying for the structural FX treatment to recognise the hedging effect of FX positions on the T1 ratio[14].

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

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

[14] It should be noted that the same reasoning can be applied in the context of the total capital ratio.

where:

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

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

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

$$\text{Tier } 1(FX_{FC}) = \sum_{j=0}^{\infty} T_j \cdot \left(FX_{FC} - FX_{FC_0}\right)^j$$
$$= T_0 + T_1 \cdot \left(FX_{FC} - FX_{FC_0}\right) + \sum_{j=2}^{\infty} T_j \cdot \left(FX_{FC} - FX_{FC_0}\right)^j \quad (2a)$$

where:

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

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

(iii) the coefficients T_j are not dependent on FX_{FC}.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

where:

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

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

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

Combining that:

a. $C_1^{Optimal}$ is the value of C_1 for which the sensitivity of the ratio with respect to changes in the relevant exchange rate is equal to zero;

b. $C_1 \cong OP_{CET1}$ following the reasoning in the previous paragraph;

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

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

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

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

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

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

Annex II: Stylised examples of the application of the structural FX provision

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

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

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

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

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

The FX position corresponding to an asset in green is of type A, since the item bearing FX risk is an investment in the subsidiary[15]. Assets in yellow are positions of type B, as they are not investments in a subsidiary.

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

Parent bank at the solo level reporting in EUR:

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

[15] It may be the case that the investment is deducted from the institution' own funds – in that case, the position would not be subject to the FX own funds requirements in the first place.

Subsidiary at solo level reporting in GBP:

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

Institution at consolidated level reporting in EUR:

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

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

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

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

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

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

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

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

Assumption: all positions are banking book positions.

Parent bank at solo level reporting in EUR:

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

Subsidiary S1 at solo level reporting in GBP:

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

Subsidiary S2 at solo level reporting in DKK:

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

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

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

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

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

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

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

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

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

Example 4: Computation of the maximum open position

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

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

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

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

Accordingly:

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

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

$$MaxOP = EUR\ 5.1123$$

As a result[16]*:*

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

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

[16] Explanation of the figures:
Net open position in GBP (value in EUR) = Assets 3 in GBP + Assets 4 in GBP – liabilities in GBP = 20 + 40 – 40 = 20
Capital charge for FX = net open position structural – Max open position = 20 - 5.112359551 = 14.88764045

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

'New' net open position	5.112359551

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

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

As a result:

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

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

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

Suppose that the institution hedges the T1 ratio and that part of the T1 instruments has been issued in the foreign currency and the remaining parts have been issued in the reporting currency. In addition, for the sake of simplicity, it is assumed that no own funds requirements exist for market risk (except FX risk), operational risk, counterparty credit risk and CVA risk.

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

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

Suppose the risk weight for credit risk is 0.8 for assets in EUR and 0.5 for assets in GBP. The total RWAs (without FX charge) are EUR 470[17]. The T1 ratio is 0.42553.

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

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

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

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

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

[17] RWAs with no FX charge = 0.8 * 400 + 0.5 * 300 = 470.

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

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

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

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

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

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

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

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

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

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

$$Sensitivity = \frac{S\_OP \; - \; MaxOP}{RWA_{NoFX\_FC}} = 0$$

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

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

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

Computing the sensitivity above under this new scenario we get:

$$Sensitivity = -0.262\%$$

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

Example 7: Items at historical cost

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

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

$$MaxOP = 0$$

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

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

The parent institution, which reports in EUR, owns a subsidiary reporting in GBP. At the consolidated level, the institution reports in EUR. Furthermore, it is assumed that no items are deducted from CET1, that no trading book exists and that no own funds requirements exist for operational risk and CVA risk. The risk weights for credit risk are assumed to be 100% for all assets and the market risk RWAs are calculated using the standardised approach. Finally, it is assumed that the permission to offset the positions in the subsidiary and the parent bank in accordance with Article 325b CRR has been granted.

Parent institution at solo level reporting in EUR:

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

Subsidiary at solo level reporting in GBP:

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

Institution at consolidated level reporting in EUR:

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

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

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

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

If the institution has the structural FX waiver for the solo level and for the consolidated level, then the RWA figures and capital ratios are as follows:

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

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

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

Parent institution at solo level reporting in EUR:

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

Subsidiary at solo level reporting in GBP:

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

Institution at consolidated level reporting in EUR:

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

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

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

For the parent bank, at individual level the position in the foreign currency is a short position and no waiver can be applied. Thus, hedging the ratio at the consolidated level leads to higher own funds requirements at the solo level (compared with the previous example). The maximum open position at the consolidated level is equal to $150/1\,000 \cdot 300 = 45$*. If the institution has the*

structural FX permission at the consolidated level, then the RWA figures and capital ratios are as follows:

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

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

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

Parent bank at solo level reporting in EUR:

	Value in EUR		Value in EUR
Assets in EUR (BB)	500	Liabilities in EUR (BB)	400
		Liabilities in USD (BB)	40
Assets in USD – partic-ipation (BB)	20	Liabilities in USD – T1 (BB)	10
Assets in GBP (BB)	30	Liabilities in SEK (BB)	10
		Liabilities in DKK (BB)	10
		CET1 in EUR	80

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

Subsidiary at solo level reporting in USD:

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

		CET1 in USD	240

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

Group at consolidated level reporting in EUR:

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

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

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

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

(i) the position in US dollars stems from the trading book and as such it does not meet the minimum requirement in Article 5.

(ii) the position in SEK is short at group level and as such it does not meet the minimum requirement in Article 5.

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

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

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

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

As mentioned in the background section, the hedging effect of a position is the same regardless of whether the permission in Article 325b has been granted or not. That is why, for the purpose of Article 4, whether a position is net long or net short has to be assessed considering all positions in the group (i.e. regardless of whether they are booked at parent bank level or at subsidiary level).

However, the requirements in Article 4 are more stringent where the permission is sought by an institution without the permission referred to in Article 325b. Specifically, the requirement in Article 4(1)(f)-(g) applies to cases where the permission for which the exemption is sought is short at the level of the institution (or subset of institutions) constituting the group.

In the example, we are considering the case of an institution that does not have the permission referred to in Article 325b. Therefore, it has to be checked whether the requirements in Article 4(1)(f)-(g) are relevant or not:

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

   As a result, positions in GBP meet the conditions in Article 4(1)(f)-(g) does not entail any other constraint.

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

   Following Article 4(1)(f)-(g), this means that the positions in the parent bank can be further considered in the assessment of the application if they have been taken or are maintained with the sole purpose of hedging the consolidated ratio. As also mentioned in the background section, the term ‘position’ refers to the position in the foreign currency and not to the items from which it stems. As a result, the competent authority should check that the position at the parent bank level (–50) is maintained with the sole purpose of hedging the ratio. For example, in this specific case, the institution may keep the position at parent bank level for the purpose of reducing the position stemming from the subsidiary, and it adjusts

the short position booked by the parent bank depending on the value of the long position stemming from the subsidiary. Hence, the position at parent bank level could be considered to be taken with the sole purpose of hedging the ratio.

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

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

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

   Following Article 4(1)(f)-(g) of the RTS, it means that the positions in the parent bank can be further considered in the assessment of the application if they have been taken or are maintained with the sole purpose of hedging the ratio.

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

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

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

As a result:

1. All positions in USD for which the exemption is sought meet the requirements in Article 4;

2. All positions in GBP for which the exemption is sought meet the requirements in Article 4 ;

3. With regard to the position in DKK, in principle the institution has a number of possibilities:

   (i) the institution could request the permission only for the long position stemming from the subsidiary;
   (ii) the institution does not proceed further with its intention of receiving the permission for its positions in DKK;
   (iii) the institution could revise how the positions at parent bank level are managed to prove that they are maintained with the sole purpose of hedging the ratio.

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

   The positions in DKK stemming from the subsidiary meets the requirements in Article 4. Hence, the competent authority should proceed in verifying whether the institution meets the other requirements for those positions.

With respect to the structural nature, in the simplified balance sheet, items related to positions of type A for which the presumption of the structural nature has been recognised in the RTS are highlighted in green. All other positions (those highlighted in yellow or orange) are positions of type B.

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

In the example that we are analysing:

1. For positions of type B in USD, that justification could be based on the fact that they are managed with the sole purpose of hedging the ratio. For example, given this objective, the institution can prove its intention to roll out those positions as soon as they mature and to eventually adjust them to the extent needed to meet the objective in the risk management strategy. In this example, we assume that the competent authority determines that those positions are structural.

2. For positions of type B in GBP we differentiate between:
   (i) positions of type B booked in the parent bank;
   (ii) positions of type B stemming from the subsidiary.
   We assume that positions of type B in the parent bank are items that the institution aims to keep in the long term (e.g. real estate not held at historical cost).

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

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

3. For positions of type B in DKK:

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

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

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

The competent authority should check that all requirements relating to the risk management framework (Article 8) are met. While assessing those requirements, it is important also to cross-check, for example, that the justification provided for validating the structural nature of a position of type B is consistent with what is stated in the strategy itself.

For simplicity, we assume that those requirements are met for all three currencies. It should be now determined the amount that can be actually excluded from the net open position.

It is worth noting that the size of the structural net position must be determined regardless of the fact that the permission in Article 325b has been granted, i.e. all positions that are structural are to be net when applying Article 7 (as per Article 7(1)(d)).

Suppose that, following the calculation of the maximum open position, the institution obtains the following result:

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

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

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

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

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

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

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

In the context of DKK, the maximum open position is greater than the structural net position; as a result, all positions in DKK stemming from the subsidiary can be excluded when computing the own

funds requirements for FX risk. However, the institution still needs to capitalise the short position at the parent bank level. It should be noted that, in cases of under-hedges (i.e. the maximum open position is greater than the structural net position), it is not relevant to identify where the remaining structural position to be capitalised has to be 'allocated', since there is no structural position that exceeds the maximum open position.

Annex III: Reporting on Structural FX positions: Templates

C 24.02 Market risk: Structural foreign exchange positions (MKR SFX)

Currency	Overall risk position (before any exemption)						Capital ratio hedged	Maximum open position	Hedging technique	Sensitivity of the capital ratio with respect to changes in the FX rate		(-) Net reduction of own funds requirements for market risk resulting from the application of Delegated Regulation X/Y	$RWEA_i^{Art92(4)(a)} / \sum_j RWEA_j^{Art92(4)(a)}$
		Positions that are structural and deliberately taken for hedging the ratio			Positions that are not structural or are not deliberately taken for hedging the ratio					Sensitivity according to regulatory formula	Sensitivity according to internal methodology		
			Items referred to in Article 6(1), point (a) of Delegated Regulation X/Y	S_OP	Trading book positions subject to own funds requirements for FX risk (net)	Banking book positions not meeting the S-FX requirements (net)							
0010	0020	0030	0040	0050	0060	0070	0080	0090	0100	0110	0120	0130	0140

(green = new template)

Annex IV: Reporting on Structural FX positions: Instructions

Specification of reporting population and frequency and application of entry and exit criteria

Institutions shall report the information set out in template 24.02 of Annex I, in accordance with the instructions provided in Annex II, Section 9.4 [where they have obtained a permission to exempt risk positions from the own funds requirements for foreign exchange risk in accordance with Article 104c of Regulation (EU) No 575/2013], on individual or consolidated basis, as applicable, with a quarterly frequency.

[The entry and exit criteria of Article 4 of Regulation (EU) 2021/451 shall not apply.]

‘9.4 C 24.02 - Reporting on the exemptions for structural foreign exchange positions

9.4.1 General Remarks

1. This template contains information for assessing and monitoring the implementation of the exemption of risk positions that institutions have deliberately taken in order to hedge, at least partially, against adverse movements in foreign exchange rates on any of its capital ratios, from the own funds requirements for foreign exchange risk, granted in accordance with Article 104c of Regulation (EU) No 575/2013.

2. Information shall be provided separately for every currency, where the institution has obtained a permission to exempt risk positions denominated in that currency in accordance with Article 104c of Regulation (EU) No 575/2013.

9.4.2 Instructions concerning specific positions

Column	Legal references and instructions
0010	**Currency** The ISO code of the currency shall be reported. This is a row identifier, and shall be unique for every row reported in this template.
0020	**Overall risk position (before any exemption)** Article 8(1), point (m)(i), of [the RTS on S-FX]
0030	**Positions that are structural and deliberately taken for hedging the ratio** Article 8(1), point (m)(ii), of [the RTS on S-FX]

	The overall risk position relating to positions that meet the requirements referred to in Article 2(1), of [the RTS on S-FX] shall be reported.
0040	**Items referred to in Article 6(1), point (a), of Delegated Regulation X/Y** Article 8(1), point (m)(iii), of [the RTS on S-FX] The overall risk position relating to items referred to in Article 6(1), point (a), of [the RTS on S-FX] shall be reported.
0050	**S_OP** Article 8(1), point (m)(iv), of [the RTS on S-FX]
0060-0070	**Positions that are not structural or are not deliberately taken for hedging the ratio**
0060	**Trading book positions subject to own funds requirements for FX risk (net)** The overall risk position relating to items allocated to the trading book that are subject to own funds requirements for foreign exchange risk shall be reported.
0070	**Banking book positions not meeting the S-FX requirements** The overall risk position relating to items allocated to the non-trading book (banking book) that do not meet the requirements referred to in Article 2(1) of [the RTS on S-FX] shall be reported.
0080	**Capital ratio hedged** The ratio that the institution aims to hedge shall be indicated as one of the following: - CET1 ratio - T1 ratio - Total capital ratio
0090	**Maximum open position** Article 6(2), of [the RTS on S-FX]
0100	**Hedging technique** The hedging technique applied by the institution, as referred to in Article 7(1), point (b), of [the RTS on S-FX], shall be indicated as one of the following: - Under-hedge - Perfect hedge - Over-hedge

0110-0120	**Sensitivity of the capital ratio with respect to changes in the FX rate**
0110	**Sensitivity according to regulatory formula** Article 8(1), point (m)(vi)(i), of [the RTS on S-FX]
0120	**Sensitivity according to internal methodology** Article 8(1), point (m)(vi)(ii), of [the RTS on S-FX]
0130	**(-) Net reduction of own funds requirements for market risk resulting from the application of Delegated Regulation X/Y** Article 8(1), point (m)(vii), of [the RTS on S-FX]
0140	$\frac{RWEA_i^{Art92(4)(a)}}{\sum_j RWEA_j^{Art92(4)(a)}}$ Article 8(1), point (m)(xii), of [the RTS on S-FX] Institutions shall report RWEA as referred to in Article 92(4), point (a), of Regulation (EU) No 575/2013, pertaining to exposures denominated in the foreign currency i ($RWEA_i^{Art92(4)(a)}$) in percent of the RWEA referred to in Article 92(4), point (a), of that Regulation, pertaining to exposures in all foreign currencies ($\sum_j RWEA_j^{Art92(4)(a)}, i \in [1, \dots, j]$).