Comments

Draft Guidelines on capital measures for foreign currency lending to unhedged borrowers in the SREP

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The **German Banking Industry Committee** is the joint committee operated by the central associations of the German banking industry. These associations are the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), for the cooperative banks, the Bundesverband deutscher Banken (BdB), for the private commercial banks, the Bundesverband Öffentlicher Banken Deutschlands (VÖB), for the public-sector banks, the Deutscher Sparkassen- und Giroverband (DSGV), for the savings banks finance group, and the Verband deutscher Pfandbriefbanken (vdp), for the Pfandbrief banks. Collectively, they represent more than 2,000 banks.

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General Comments

As part of a company's credit assessment, in the field of corporate finance, foreign currency risks have to be identified and evaluated in the same way as other material risks. This does not present a new requirement. Instead, it has always been part and parcel of a bank's risk analysis process. Based on the foregoing, we advocate in favour of a solution where the "foreign currency risk" shall not be incorporated under Pillar II as a separate risk type.

Furthermore, we would like to point out that, both in this Consultation Paper as well as in the recommendation of the European Systemic Risk Board it is being emphasised that the regulatory measures are primarily geared towards private individuals - who for speculation reasons or, moreover, in order to reduce their interest burden - take out loans in another currency (that differs from their current earnings). Nevertheless, the scope of application of the present Consultation paper is not limited to private individuals. From our point of view, this approach is worth reviewing. In our view, an application of the requirements to internationally active companies or, moreover, corporate groups is not feasible. Hence, we advocate in favour of a solution where the scope of application is limited to private individuals. As an alternative regulatory choice, there is an absolute need to specify that companies which enter foreign currency risk without any speculative intent and which manage their foreign currency risks correspondingly, are by definition considered "hedged borrowers".

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Specific Comments

More detailed concept clarification of FX lending (page 8)

Under the term "FX lending" (page 8), the Consultation Paper enumerates the following criteria in order to define foreign currency loans: „...member state in which the borrower is domiciled" and "...currencies other than the legal tender of the relevant jurisdiction". Foreign currency lending is a very complex activity and if interpreted by the provided wide definition, can encompass many forms. In the absence of any further explanations, this concept clarification cannot be transposed to all funding types. For instance, it remains unclear how an investment fund company should be categorised which is not domiciled in the same risk country that is underlying the loan. Another moot point is how to categorise an FX loan to a one-ship company under a foreign flag. Furthermore, the proposed definition also leads to inappropriate categorisations. For instance, a loan denominated in US Dollar to an American company would be categorised as an FX loan, as soon as the place of jurisdiction is, for instance, in London. However, especially in international transactions, the place of jurisdiction will frequently be different from the borrower's domicile. This should be taken into account accordingly. We strongly suggest specifying this concept in greater detail and thus circumventing the possibility of having different individual interpretations of foreign currency lending based on this Consultation Paper.

More detailed concept clarification of the term "hedged borrower" (page 8)

Also the term "hedged borrower" (page 8) requires a definition that is geared more towards practical realities on the ground. The definition of the term "hedged borrower" should be worded in a way that takes greater account of practical realities and it ought to be confined to the user group of private households. This is necessary on the following grounds:

Initially, the Consultation Paper only contemplates the individual FX loan. In practice, however, especially in larger companies a hedge cannot be reflected on an individual loan basis. Generally, risk management controls a host of payment flows in different currencies exclusively from an overarching perspective. Hence, especially for companies with comprehensive FX business activities, we hold the view that reviews on the basis of individual loans would be neither effective nor efficient. It would appear more appropriate to equally predicate the review practice on an overall assessment. Hence, the terms "natural hedge" and "financial hedge" should be designed in a manner that is closer to practical realities on the ground. This applies in particular given that, in our view, the boundaries between "hedged" and "unhedged" are unambiguous only for private borrowers. Both, in the present Consultation Paper but also in the recommendations by the European Systemic Risk Board published on 21 September 2011, it has been repeatedly emphasised that regulatory needs primarily affects private individuals and small SMEs without any cross-border activities. In our experience, when it comes to international players with subsidiaries in various countries as well as funding transactions in different foreign currencies, it may be assumed that the company is aware of the FX risks and manages them proactively. Hence, a general categorisation of such companies as "hedged" should be permissible.

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Consequently, we suggest confining the regulatory scope of special rules on FX loans to credits to private households. If and when a categorisation of "hedged/unhedged" shall also be made with regard to large international funding transactions, a further definition of the boundaries between the concepts "hedged" and "unhedged" is inevitable.

In this context, it is also worth noting that currently, credit institutions have not yet implemented any technical feature for identifying "hedged / unhedged borrowers". Given the host of IT adjustments which were triggered by supervisory changes in recent years, there should be an in-depth review whether a corresponding IT implementation of this feature is necessary. Depending on the forthcoming specifications that are still indispensable, we are concerned that there will be a major implementation burden in the absence of any adequate cost-benefit ratio.

Analysis of the impact of FX risks to legal risks and reputation risks unclear (page 11)

In the Consultation Paper on page 11 (second item of the enumeration) there is a request for a separate review of the impact of FX lending risk on institutions' reputational and legal risks. Because it is our understanding that no new requirements are being defined, in our opinion, this paragraph could be deleted. Already today, all specified risks are subject to comprehensive reviews. Should the proposed rule refer to more detailed analyses, we would welcome it if the requirements were specified in greater detail to this effect.

Faulty order of magnitude (page 20, item 46)

Furthermore, we hold the view that on page 20 item 46, the information on banks' orders of magnitude is incorrect. We would appreciate a correction.