



EBA/CP/2013/20

August 23<sup>th</sup> 2013

**SUBJECT: Comments of BNP Paribas on EBA's draft Guidelines on Capital measures for foreign currency lending to unhedged borrowers under the Supervisory Review and Evaluation Process (SREP) – In reference to consultation paper EBA/CP/2013/20**

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As an international banking group, BNP Paribas is watchful about concerns raised in ESRB's report<sup>1</sup> in terms of negative cross-border spill-over of excessive foreign currency lending and welcomes subsequent EBA's guidance towards competent authorities for supervising actual ability of institutions to assess and mitigate material risk arising from foreign currency lending to unhedged borrowers.

The draft Guidelines integrate the proportionality principle through a specific materiality threshold and the use of supervisory scoring for the determination of potential additional capital requirements. BNP Paribas considers that such proportionate approach is particularly relevant in the present case.

However, BNP Paribas is of the opinion that these proportionality measures may need to be adjusted.

#### **a. Materiality threshold**

The Guidelines (5) explicitly define a materiality threshold<sup>2</sup> with the legitimate concern of targeting the risk where it is actually relevant and necessitates specific attention. However, the merit of this approach is significantly weakened by the parallel provision stating "*Competent authorities should also apply the guidelines where an institution does not meet the threshold set out above but the FX lending risk to unhedged borrowers is nevertheless considered by them to be material.*"

As a matter of fact, this provision opens the door to unlimited discretionary interpretations by supervisors who would be easily able to override the objective criterion proposed in the

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<sup>1</sup> ESRB/2011/1

<sup>2</sup> "*Loans denominated in foreign currency to unhedged borrowers constitute at least 10% of an institution's total loan book (total loans to non-financial corporations and households), where such total loan book constitutes at least 25% of the institution's total assets.*"



Guidelines; it makes the previously defined materiality threshold virtually void. We consider that this contradicts EBA's efforts to harmonise supervisory practices within the Member States; for the supervised Institutions, this creates the risk that they face multiplication of local standards with respect to the FX lending risk.

In order guarantee a reasonable and consistent application of the proportionality principle, BNP Paribas proposes to frame this national discretionary provision by:

- Providing an indicative list of macro and/or micro economic criteria<sup>3</sup> which could lead to the application of the Guidelines despite the fact that the materiality threshold is not met,
- Requesting Competent Authorities to formally justify any decision to override the materiality threshold, on the basis of the above suggested criteria (or for other reasons which would need to be specifically documented).

#### **b. Use of Supervisory risk scores**

The Guidelines set gradual and proportionate Pillar 2 supervisory requirements relying on supervisory risk score (24). However, in our opinion, the proposed method tends to systematically and solely impose capital add-ons, while other mitigation measures are only brought forward in the Guidelines as part the SREP expectations<sup>4</sup>.

Such mitigation alternatives should be particularly relevant for institutions where the risk is considered "Low" (risk score of "1"). Indeed, necessity to impose a capital add-on in this case appears to be unjustified and even contradictory.

As a consequence, BNP Paribas proposes to enlarge the set of requirements resulting from the supervisory scores to the whole measures referred to in the Guidelines: strengthening internal processes for monitoring and controlling the risk would be the foremost requirement assigned to "Low" risk institutions, whereas institutions bearing a more significant risk could be subject to capital add-ons according to a rearranged grid, starting from level 2 of risk score ("Medium – Low")<sup>5</sup>.

#### **Scope and definitions**

Finally, we think that for sake of clarity, some definitions in the Guidelines may need to be revisited.

- Title I §2 defines 'FX' as '*any currency other than the legal tender of the Member State in which the borrower is domiciled*' thus suggesting that institutions should only consider EU

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<sup>3</sup> e.g. Significant increase of institution's FX lending over a relevant period of time; negative trend of FX rate or constraining FX regime of the domestic currency against significant foreign currencies in which institution's loans are denominated.

<sup>4</sup> "... requiring reinforcement of the relevant arrangements, processes, mechanisms and strategies, requiring additional provisioning and/or requesting improvements to the ICAAP methodologies, ..."

<sup>5</sup> e.g. [0%,33%] for risk score "2", [33%, 66%] for risk score "3" and >66% for risk score "4"



borrowers when estimating the materiality threshold.

By using 'Member State' instead of 'Country' the guidelines certainly address consumer protection in the EU but only partially cover cross-border spill-over effects.

- In §5, the materiality threshold is set as a percentage of the institution's total loan book, the "total loan book" being restrictively defined as "*total loans to non-financial corporations and households*". Conversely, in the formula presented in paragraph 24, reference is made to the proportion of the "*Pillar 1 capital requirement for credit risk*"; in our understanding, this implicitly refers to the whole loan book, i.e. not only limited to loans to non-financial corporations and households. It seems that the proportions at stake are not consistent with each other and this appears to be a source of confusion for proper application of the Guidelines. We request EBA to consider relevant amendments.

## **Conclusion**

In general, BNP Paribas, as a cross border group, supports efforts to harmonise supervisory requirements and processes. The common framework and the proportionality principle conveyed in the draft Guidelines under discussion concur to this objective but need to be strengthened by

- clearly specifying exceptions to this common framework (Materiality threshold)
- and ensuring a constant relevancy and proportionality between risk profiles and supervisory level of expectations.