EBA Consultation Paper on draft Regulatory Technical Standards on the treatment of structural FX positions under Article 104c of Regulation (EU) No 575/2013 (CRR) and on the reporting on structural FX positions

Summary

Svenska Handelsbanken AB (publ) (Handelsbanken or the Bank) has been part of the development of EBFs comments on the draft regulatory standard and support its content.

Since Handelsbanken has a comparatively unique structure with regards to structural fx-risks and the RTS mainly focuses on group structures built on subsidiaries, with lending mainly in their own local functional currency, we want to highlight the lack of clear guidance for other group structures.

The Bank has a branch structure and a business model which focuses on non-trading book products with a minimal trading book activity. There is a significant lending in the functional currencies in our home markets but a significant portion of the funding is made in EUR and USD. At the same time approximately 50 per cent of the Risk Exposure Amount (REA) is in foreign currencies since our clients in Sweden and Norway to a large degree lend in EUR and USD. This is due to the fact that they have significant cash-flows in those currencies (large global clients).

Since the proportion of REA in foreign currencies are significant, the need to manage the volatility in the CET1-ratio due to movements in foreign currencies is high. Therefore, it is important that prudent regulation recognizes the importance of those risk management activities and support them in a balanced manner rather than giving incentives to reduce the capital requirement of fx risk by simple closing all long positions by funding in the same currencies and instead accept the volatility in the prudent capital ratios.

We therefore want to highlight that the RTS should support:

- Including non-trading book positions regardless if they are cross-border or not
- Entities with branch structures on an equal footing as entities with subsidiaries
- Aggregating positions across subsidiaries/branches in single currencies for the reporting entity (i.e. parent and consolidated situation) when the maximum open position for structural fx-risks are calculated

Below you will find our details remarks. Please do not hesitate to reach out for any clarifications on the remarks made.

Questions relating to the draft RTS

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

No, we do not agree with the proposal, and we urge to amend Article 4(1)(e) and delete recital (4).

We understand '*internal trades*' in the Q3 as transactions from the non-trading book to the trading book, not financing transactions between different non-trading books.

The limitation as such with regards to structural fx-risk position is contra intuitive since entities not managing the volatility in prudential capital ratios due to fx-movements are rewarded with a lower capital requirement.

We do understand the reasons for proper governance requirements for structural fx risk since there are incentives to classify trading positions as non-trading book positions if the requirements were insufficient.

Given proper governance prudent regulation should support instead of penalizing the management of structural fx-risks in the non-trading book positions. Therefore we consider that the proposed limitations are contra productive. Instead, the main focus of prudent regulation should be on the proper governance around the classification of position between the trading and the non-trading book.

To the extent that transactions are executed by the non-trading book in the framework consistent with Article 8, they should be eligible to be included in the net open position for the identification of potential capital requirement.

To the extent that those transactions are with the trading book, the risk would be transferred to the trading book and generate a foreign exchange trading risk capital requirement if those positions are not offset. The discrepancy, if any, between the internal transactions and the offset of its risks would hence generate capital requirement for foreign exchange risk in the banking book.

Net position, internal transactions, branches

The draft RTS separate its discussion between separate and consolidated entities focusing on separate legal entities. The analysis made and the conclusions drawn is based on that structure. The draft therefore lacks an analysis of entities having a branch structure instead of a structure with subsidiaries.

The analysis therefore misses that group internal as well as parent internal lending and funding may have an impact on the financial position and P&L, something that is recognized in IFRS standards that accept internal transactions to be formally documented as hedges of fx-risk since they may have an impact on the financial position and performance of an entity (IFRS 9.6.3.5f.).

The example on page 17 may illustrate that lack of analysis of branch structures. If S1 and S2 was changed to B1 and B2 instead, the lending to the parent from the branches would be considered to be internal transactions that should be ignored. If being ignored the "B1" has a short position that EBA considered should be carefully considered even though in internal risk management B1 has a zero position.

P49 states that EBA expects that only the parent entity has a short position to hedge an overall long fx-position.

The EBA guidance should clarify that this statement does not consider that an internal loan funded with an external debt instruments is considered to be a short position at the subsidiary/branch level, i.e. that internal lending from a subsidiary/branch to the parent with the purpose of moving liquidity to the parent, create a short position. E.g. an bond issuance made of an US branch may finance USD lending of a parent having SEK as it reporting and functional currency.

In the Corep report for the parent and the group, the USD position of a branch is a short position at the branch level, given that internal transactions are eliminated in the consolidation of both the parent and the group.

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

We recommend amending Article 5 as below:

> *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 subsidiaries and branches;*
>
> *b) on a consolidated basis, non-trading book risk positions that stem from investments subsidiaries and branches;*
>
> *c) non-trading book risk positions that relate lending in other currencies than the functional currency of the reporting entity*

In financial reporting an investment can be made in both subsidiaries and branches, there is no difference with regards to the classification or how the local financial statements of a branch or a subsidiary is consolidated into the consolidated financial statements. Furthermore, for branches that consolidation process take place already when the separate financial statements of the parent is prepared. Therefore it is important that the RTS recognizes the investments, structural fx-risk hedges and the effect translation of local financial statements of both subsidiaries and branches. At present too much focus is made on subsidiaries.

Bullet c) above is also important. At present the implicit assumption in the draft RTS is that foreign currency lending mainly take place in subsidiaries of the parent and the local prudent regulator should show skepticism if an institution include these in structural fx-risk positions.

The draft RTS thereby ignore the situation of those institutions whose functional currency is small (e.g. SEK and NOK) but their corporate clients to a large extent lend in USD or EUR since they either export or import goods whose trade currencies USD or EUR.

It is important that draft RTSs makes clear that those non-trading book positions should be included in the structural fx-risk positions. Therefore we consider that the focus on “cross-border” in the draft RTS should be deleted.

The Swedish large corporate market is characterized by several global export companies as well as large importers of goods. The trading currencies for those entities are dominated by EUR and USD wherefore they often lend in those currencies. Based on the wording of the draft RTS, those would only be accepted by exception if the lending is made by the export and import companies in Sweden, but would be accepted if their foreign subsidiaries instead lent those funds from Sweden. We fail to see the merit in such restrictions.

Important to notice is that the funding of those non-trading book positions may be made from foreign branches or subsidiaries that have lent the foreign currency locally in their functional currency, whereafter the funds are transferred in internal lending transactions from the branches and subsidiaries to the parent entity in Sweden.

Additional Comments

Calculation of maximum open position

In order to reduce potential disagreements/misalignments with supervisors it would be beneficial to further clarify that the calculation of the maximum open position should include all assets within an entity or consolidation of entities to correctly capture the sensitivity of the capital ratio with regards to changes in FX rates. Assume the following example, a parent (reporting in SEK) has two branches, branch 1 reporting in SEK and branch 2 reporting in EUR. Branch 2 has a net-long position in EUR taken in order to hedge the CET1-ratio from a consolidated perspective. However, since the net EUR assets in branch 1 equals zero the net-long EUR position in branch 2 has to account for the FX-effects on the CET1-ratio stemming from branch 1 as well. Hence, if only EUR assets in branch 2 is included the maximum open position will not be the position that hedges the consolidated CET1-ratio.

Branch 1, SEK as reporting currency			
	Value in SEK		**Value in SEK**
Assets in SEK	140	Liabilities in SEK	105
Assets in EUR	10	Liabilities in EUR	10
		CET1 in SEK	35

Branch 2, EUR as reporting currency			
	Value in SEK		**Value in SEK**
Assets in EUR	30	Liabilities in EUR	20
		CET1 in EUR	10

Consolidated branches with SEK as reporting currency			
	Value in SEK		**Value in SEK**
Assets in SEK	140	Liabilities in SEK	105
Assets in EUR	40	Liabilities in EUR	30
		CET1 in SEK	45

This becomes apparent in the table below where we assume that all assets have a risk-weight of 100% and assume an appreciation/depreciation of EUR against SEK by +/- 10%. Given the inclusion of the EUR assets in branch 1, the maximal open position hedges the CET1-ratio.

Consolidated RWA and CET1 in SEK			
	Before stress	EUR +10%	EUR -10%
RWA	180	184	176
CET1	45	46	44
CET1-ratio	25.0%	25.0%	25.0%

The above illustration is for example relevant for Nordic non-euro countries with substantial EUR and USD assets due to customer demand from global export companies.

Stockholm 6 February 2025,

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