Consultation Response

Consultation 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 (EBA/CP/2024/21)

February 2025

The Association for Financial Markets in Europe (AFME) welcomes the opportunity to comment on the EBA's **Consultation on Draft Regulatory Standards concerning the treatment and reporting of structural FX positions (EBA/CP/2024/13)**. AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.

AFME is the European member of the Global Financial Markets Association (GFMA) a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia.

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We summarise below our over-arching comments in relation to the consultation, which is followed by answers to the individual questions raised.

Overall comments and observations:

There is a strong consensus among AFME and its members as to how banks using existing waivers should be able to continue to do so, and that the materiality threshold of the top ten currencies or 1% in terms of the credit risk RWA appears rather arbitrary and does not seem to be underpinned by any logic.

There is also a consensus that internal trades between the banking book and the trading book should be recognized as hedging the capital ratio upon evidences that internal trades are consistent with FXBB management framework (article 8) and that external trades offset those internal transactions.

Within the scope of the RTS a particular challenge arises when dealing with structural FX positions that exceed the maximum open position eligible for exemption. In such cases, determining which entity within a consolidated group should bear the remaining FX position becomes essential. Under the CRR's FX risk calculation framework, and in the absence of the position referenced in Article 325b (which restricts the ability to offset FX positions between the parent and subsidiary), assigning the remaining position after the waiver (or the full structural position when the waiver is not granted) to the parent, where the risk materialises, can be justified for a number of reasons. These include the situation that the local currency of a subsidiary does not generate any FX risk for the entity, the FX risk arises at the consolidated (parent) level together with and associated FX losses or gains and that managing translation risk is normally a parent level responsibility.

<u>Continuity with the Currently Applicable Guidelines</u>

The EBA Guidelines on the Treatment of Structural FX under Article 352(2) (EBA Guidelines) has entered into force in January 2022 and already factored in all existing and expected regulatory requirements.

It is expected that the RTS is aligned with the existing Guidelines and that its implementation would not trigger another waver application requests.

It would be valuable that EBA clarifies that the implementation of the RTS is not expected to jeopardize or modify the currently applicable exemptions.

<u>Continuity with the Currently Applicable Supervisory Reporting</u>

When exemptions have been approved, banks have been subject to regular supervisory reporting (i.e. SSM Template).

It is expected that the ITS, if any (*), should be aligned with currently applicable SSM Template in terms of content and reporting frequency.

(*): we believe it is not necessary to have another ITS reporting requirement, and that it is not envisaged by level 1 text.

<u>Transitional arrangements</u>

Art. 6 (3) Commission Delegated Regulation should reflect the transitional arrangements for the output floor according to Art. 465 CRR3 instead of introducing the static 72,5%, which is only relevant from 2030.

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

No, we consider more clarity is needed.

1 IMA application

The draft RTS explains under Art. 1 that banks will have the possibility to use two standardised approaches for computing own funds requirements for market risk. It is not clear though, if banks applying internal model approach (Art. 325 (1) (b)) are equally applying Art. 1. We would appreciate a clarification for IMA banks.

2 Items that may lead to gains or losses that do not impact CET1

Consistent to the current EBA Guidelines on Structural FX this draft RTS allows the exclusion of items that may lead to gains or losses that do not impact CET1 in addition to maxOp, if they are of structural character. However, it is unclear, which items precisely might qualify for such treatment. From our perspective prudential filters listed under Art. 32-35 CRR should be captured by the term “items that may lead to gains or losses that do not impact CET1”. This should be clarified in Art. 6 (1) (a) (ii) draft RTS.

3 Capital deduction items

It is acknowledge in Art. 325 (1) CRR3 that capital deduction items shall be deducted from the exposure leading to own fund capital requirements when calculating the own funds requirements for fx risk. We would still appreciate, that EBA in addition clarifies, that the exemption covers items listed in Art. 36.

Question 2: 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.

No, we do not agree with the proposal, and we urge the deletion of Article 3, Article 2(1)9a) and recital (1)

While the EBA refers to supervisory experience and level playing field reasons during the Public Hearing hold in December, we do not agree on the limitation of the total number of currencies to be allowed for a waiver. The proposed wording should consider/accommodate the reality of all banks, otherwise banks with a large international presence would be unduly penalized due to its organisational structure.

The limitation proposed would conflict with the Level 1 text and appear to have no regulatory basis. It would lead to capital requirements with no underlying reason. It would also lead to increased complexity as the currency composition of each institution will evolve over time leading to currencies crossing the threshold in both directions. This would in turn create additional administrative burdens for banks and supervisors as the scope of the exemption would need to modified each time a currency crossed the threshold. This would not be consistent with initiatives towards simplification in Europe and would introduce undue variances in capital requirements as the scope of exemptions are modified.

As the request for exemption is at the discretion of individual banks, it is to be expected that there might be differences between institutions in relation to the currencies for which they request and apply exemptions. There appears no rationale therefore for seeking harmonization and as the request for an exemption remains at the discretion of the bank, the suggested limitation would not therefore address any concerns regarding a lack of harmonization.

In addition, the reference to only credit risk weighted amounts does not appear logical as the exemption relates to the hedging of the capital ratio which is not limited to credit risk.

As a further point, we would note that as currencies may enter or leave the top 10 credit risk RWA on a frequent basis, this could lead to frequent adjustment needing to be made to hedging strategy which does not align with the requirement of maintaining the 6 month horizon for the application of strategy.

Question 3: Do you 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.

To the extent that transactions are executed by the non-trading book in the framework consistent with Article 8, they should be eligible to 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 whose risks are capitalized. The discrepancy, if any, between the internal transactions and the offset of its risks would hence be subject to capital requirement.

In this framework whereby:

• the transactions is consistent within the risk framework required by Article 8,
• the trading book capitalizes any discrepancy between the transferred risk from the internal transactions and the offsetting trading book transactions;

there is no reason to exclude those internal risk mitigating transactions from the overall risk position.

Not recognizing internal risk mitigating would be detrimental to execution of the risk mitigation, increase operational and counterparty risk, would introduce inconsistency as the transactions would still have to be considered for the trading book, and would be inconsistent with level 1 text and other risk types (e.g. IRRBB).

Should additional requirement be envisaged, they should consist in evidencing that external transactions in the trading book are offsetting internal transactions mitigating banking book foreign exchange risk. This is similar to the offsetting process to account internal transaction for hedge accounting transaction. Considering this offsetting process, internal transactions can actually hedge capital ratios..

Moreover, regarding 4.1.e, about internal trades, it is important to clarify that transferences between legal entities or subsidiaries of the same Group are not considered internal risk transfers.

Therefore, we would suggest amending article 4.1.e as follows:

> *Article 4.1.e) The overall risk position does not include positions resulting from internal trades between the trading book and non-trading book business of the* same legal entity; unless arrangements are implemented to evidence that such internal trades are initiated by the banking book to mitigate structural foreign exchange risk as per Article 8, and that external trading book transactions are offsetting risks from internal trades

That means, trades between different legal entities within a Group should be allowed for hedging the ratio.

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* ***undertakings*** *~~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~~* ***undertakings*** *that ~~is~~* ***are*** *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* ***(e.g. foreign branches)*** *or to a well-established business of the institution which is stable over time* ***(e.g. strategic and long term investment in equity)****.*

This enables to clarify that the below positions are part of the structural position:

- investments in entities, not unduly limited to *institutions*, which are being consolidated should be considered; this notably includes subsidiaries and foreign branches. This clarifies the inclusion of foreign branches as in the scope together with subsidiaries mentioned in the current Guideline
- Business lines which are developed within the balance sheet of an entity (no foreign branch is established) but which products are denominated in a foreign currency in a stable way through time, For instance, an entity which original capital is denominated in EUR and the rest of the assets (e.g. loans) and liabilities (e.g. deposits) are denominated in USD.
- When investments of subsidiaries denominated in FX are funded with liabilities in the same currency. The short exposures arising from these liabilities should be considered structural and also as taken to hedge the ratio.
- Structural/strategic investments in which a relevant/strategic and stable participation is maintained over time
- FX forwards purchased by the bank which 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.

The inclusion of these examples in the proposed RTS would be key to reduce potential disagreements/misalignment with supervisors.

Question 5 – Do you agree with the simplification allowing institutions to use only credit risk RWA in the determination of the MAX_OP? Please elaborate.

First, a typo needs to be fixed in Article 6(1) by substituting 'comparing' to 'summing':

> *The amount neutralising the sensitivity of the capital ratios to the adverse movements in foreign exchange rates shall be determined by ~~summing~~* ***comparing***

We would agree with the simplification and note that this is reflected to some extent in existing practice.
We agree on the simplification method as it can provide a better alternative aligned to the management of the FX exposure to hedge the CET1 ratio (or TIER ratio) than the proposed method included in the existing guidelines and it avoids the circular effect of calculating the maximum open position neutralizing the ratio. However, bank should be permitted if they wish to include components other than credit risk RWA in their MAX-OP calculation, e.g. CVA.

However, we believe institutions would benefit from additional clarity on several aspects aspects as described below.

The current proposed formula in the guidelines is biased as it artificially increases FX capital requirements when the waiver is granted for more than 2 currencies. The reason of this bias is the calculation of maximum net open exposure as *" if no waivers were granted for other currencies in accordance with Article 352(2) of Regulation (EU) No 575/2013 for positions in other currencies."* As specified in paragraph 21 (b) of Guidelines On the treatment of structural FX under Article 352(2) of Regulation (EU) No 575/2013 (CRR).

Although this approach aims to limit the possibility of regulatory arbitrage having different size of maximum open position depending on the sequence of currencies used to calculate the size of maximum open position for a currency, it creates an artificial FX exposure that increases the size of RWA No FX $_{FC}$ thus increasing the size of the denominator and reducing the size of the maximum open position. This effect creates the paradox of having capital requirements when the CET1 (or TIER1) ratio is perfectly hedged. This effect is not shown in the guidelines, as Example 4 only includes one currency with waiver,

In the following example we show how this effect works, In the example, for simplicity, only structural positions are taken (no trading or other banking book exposures), no deductions are considered, and no additional market hedges are needed to hedge the ratio, The reporting currency is the EUR and a waiver is granted for 5 currencies.

OWN FUNDS EUR	**100**	Eur mn
RWA	**600**	
CET1 RATIO	**16,7%**	

	Credit RWA	Foreign Investment Structural FX exposure
Currency 1	180,0	30
Currency 2	120,0	20
Currency 3	120,0	20
Currency 4	30,0	5
Currency 5	30,0	5
EUR	120,0	
Total	600,0	80

The investment in each subsidiary is equal to Credit RWA in currency x CET1 ratio.
In case an appreciation (or depreciation) of 20% in all currencies would occur, the new CET1 would remain unaltered as the new value of RWA will be offset by the new value of own funds. For this reason, no capital requirements would be needed.

Appreciation	20%
Deppreaciation	-20%

OWN FUNDS EUR	**116**	**84**
RWA	**696,0**	**504,0**
CET1 RATIO	**16,7%**	**16,7%**

	Appreciation		**Deppreciation**	
	Credit RWA	Foreign Investment Structural FX exposure	Credit RWA	Foreign Investment Structural FX exposure
Currency 1	216,0	36,00	144,0	24,00
Currency 2	144,0	24,00	96,0	16,00
Currency 3	144,0	24,00	96,0	16,00
Currency 4	36,0	6,00	24,0	4,00
Currency 5	36,0	6,00	24,0	4,00
EUR	120,0		120,0	
Total	696,0	96	504,0	64

The new simplified approach, established the following amount for Max Open exposure

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

Being total RWA CR Fc = 600mn the same for all currencies.

To obtain the Max Open exposure a ratio of 16,7% (100 / 600) has to be multiplied to all sensitivities for each currency, being the aggregated Max Open Exposure equal to the total investment.

Simplified Method

RWA cr	CET1 / RWA Cr	Max Op Fc	RWA FX
600		30	0
600		20	0
600	16,7%	20	0
600		5	0
600		5	0
		80	0

Simplified Method			
Max Open Exp		80	Eur mn
RWA	Credit	600	Eur mn
RWA	FX Market	0	Eur mn
Total		600	Eur mn
CET1 ratio		16,7%	

Capital Requirements for FX would be 0 for this bank.

However, when applying the current approach different "theoretical ratios" appear as the RWA No FX fc depend on the FX exposure of the rest of the currencies, as if no waiver was in place. This approach artificially increases total RWA No FX as in all case the amount is higher than Eur 600mn as expected in the previous approach, therefore reducing the Max Open Exposure and creating the need to capitalize 7 mn of new RWA.

Original Method			
RWA No FX fc	CET1 / RWA Cr	Max Op Fc	RWA FX
650	15,4%	28	2,3
660	15,2%	18	1,8
660	15,2%	18	1,8
675	14,8%	4	0,6
675	14,8%	4	0,6
		73	7

Original Method			
Max Open Exp		73	Eur mn
RWA	Credit	600	Eur mn
RWA	FX Market	7	Eur mn
Total		607	Eur mn
CET1 ratio		16,5%	

With this approach the CET1 ratio is lower than from starting point although FX volatility does not affect the CET1 ratio. In case the artificial remaining long exposure 7 mn would be hedged with a short exposure to avoid capital requirements, this would then unhedged the CET1 ratio creating volatility. In other words, it is not possible to hedge the CET1 ratio without penalization.

For these reasons, it is our opinion that the simplified approach is better aligned to the management of structural FX risk to hedge the CET1 ratio and it should be applied without considering any threshold.

This approach is aligned with the regulatory framework as non-structural FX exposures are capitalized independently of the size of the maximum open position and operational RWAs will not be materially exposed to fx since the average exchange rate is fixed in each of the 3 years instead of taking them into account at fixing.

It is important to highlight that the threshold would be most probably breached when the trading activity in one currency weights relatively more than structural exposures, which is usually the case where the structural exposure is not so material in the strategy of the bank. This adds the burden to calculate a more complex approach in the less material currencies.

In case the threshold would be kept, we would welcome clarity in some aspects:

1. **It is not entirely clear how the threshold of 80% must be calculated. The consultation paper establishes that institutions using the simplified approach when the following paragraph is met:**

   ..

“*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*”

In order to avoid misunderstandings in the usage of the simplified approach, additional guidance of how this overall risk position must be calculated is welcomed in aspects such as if the overall risk position should be calculated before or after hedges taken to hedge the ratio, at what level of aggregation must be calculated in case of art 325b is not granted and how to treat short non-structural position in banking book.

In our view this overall risk position should be calculated using the following approach:

- It should be calculated using long structural positions before hedges and the waiver. This is because this exposure is a better representation of the “natural” structural business of the balance sheet to be compared with the trading activity.
- When permission is sought on a consolidated basis It should be calculated offsetting all exposures per currency among entities. This is because, as mentioned in the consultation paper, *“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 per-mission. As a result, the numerator of the capital ratio is sensitive to the exchange rate regard-less of whether the permission in Article 325b CRR has been granted or not. “*
- Non-structural FX exposures should be calculated as net exposures across all entities. The resulting FX net exposure, whether short or long, should be considered in absolute value in both the numerator and denominator. This approach would allow to have a better comparison of the level of trading activity within a Group by each currency.

2. **When permission is sought on a consolidated basis, in case a currency does not meet the threshold, different approaches have to be used which will result in unnecessary complexity.**

   In order to avoid using different methods to calculate the Maximum Open exposure, a solution could be that the 80% threshold should be met by the aggregating all exposures in different currencies for which a waiver has been granted in a single metric. A consolidated view would also achieve the desirable outcome of allowing the simplified approach when no relevant FX trading activity is in place. Furthermore, the presence of FX activity should not weight so much in the threshold as capital requirements for trading activity have to be calculated independently from capital requirements for structural FX.

	Currency	Positive Structural Position BEFORE hedges	Net Trading book exposure	non trading book items / Overall risk position	
Currencies with waiver	Currency 1	100	20	83%	✓
	Currency 2	100	20	83%	✓
	Currency 3	100	20	83%	✓
	Currency 4	100	20	83%	✓
	Currency 5	100	30	77%	☒
	Currency 6	100	20	83%	
	Currency 7	100	20	83%	
	Currency 8	100	20	83%	
	Aggregate sum currencies with waiver	**500**	**110**	**82%**	✓

Question 6: 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.

..

Institutions currently using the derogation referred to in Article 6(4) will not necessarily qualify for the treatment referred to in paragraph 3 of this article as additional simplification options in accordance with Article 6(4) compared to Article 6(3) are necessary: The monthly revaluation of credit risk RWA components (e.g. credit derivatives) with applied currency shifts, which is still required under the simplification in Article 6(3), is very complex and overly burdensome. Article 6(4) should therefore remain in place.
We would accordingly suggest that the assumption of a linear impact of fx shifts in RWA in foreign currency should be explicitly permitted.

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

It would be beneficial to further clarify regulatory expectations about this point. Our understanding is that this should be shown by analyzing the (low) sensitivity of the CET1 ratio where RWA No FX Fc should be substituted by RWA CR Fx) as per article 8.1.m.(vi)

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

or
the sensitivity of the capital ratio with respect to changes in the exchange rate as calculated by the institution. It would not make sense to calculate two Max Open exposures using two different approaches, as this will add an unnecessary additional burden.

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

It should be beneficial about what is understood by "overestimation". i.e which is the comparable concept to compare against the Max Position using the simplified approach.

As shown in the example in answer to Q5, in the presence of more than 2 currencies with waiver the current approach will show higher RWA No Fx Fc than RWA Cr as in the latter there is no additional RWA No FX exposures for currencies as if no waivers were granted for other currencies. As these affect the denominator, the current approach provides a lower Max Open Exposure compared to the simplified approach.

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.

AFME and its members consider that the key safeguards are considered and that any additional safeguards would be for banks to consider.

The active management of a structural currency, as prescribed, is incomplete. Active management does not only imply hedging. For instance, in Argentina there is no liquid market that allows to hedge the exposition with derivatives, however there can be active investment management through the consumption of RWAs, the payment of dividends, and debt issuances, and there is also a strict control of limits and compliance with target capital.

Therefore, we consider that the redaction of the RTS should:

a) consider these different adverse scenarios and casuistic of active management of a structural currency, and
b) allow institutions to have time and additional tools to adapt to such changes, without considering that the FX management strategy of the policy does not comply with articles 8.1.j and 8.3.

We do not see the need for the introduction of additional safeguards, and recommend deleting Article 8(3) and Article 8(1)(j).

As an additional remark regarding Article 8 and the requirement that the Risk Management Framework (and associated documentation) requires Management Board approval. Although this is no change from the guidelines, we believe that there should room for the Managing Board to delegate certain authorities in this area to a sufficiently senior committee, for example an Asset Liability Committee (ALCO), with due consideration of overall risk appetite approval processes and provided of course the Managing Board itself should indeed be aware of and accept that keeping open positions with an aim to fully or partially hedge a capital ratio could lead to losses.

REPORTING

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

The representation of the RTS policy framework is leading to some issues from our understanding especially on the definitions in the template itself (see question 9)

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

The new template looks pretty similar to the FXBB one but some columns need further clarifications :
Column (030) and column (040) :

- 030 : is this columns referring to the 8.1.m.ii "the overall risk position meeting the requirement referred in art 2-1" (i.e. Exempted SOP)
- 040 : is this column referring to article 6(1)(a) « overall risk position relating to item that are structural…"(Total SOP) ?

Furthermore, the Label of the column 050 "S_OP" is not in line with the definition:. We understand this column should be the difference between Total NOP minus the exempted SOP (i.e. it corresponds to the FX net position subject to own funds requirements). And in the template in the template it is represented in the section "Positions that are structural and deliberately taken for hedging the ratio". This column is not clear to us and needs further clarification.

What is the difference between the column (070) and the (050) one. From our understanding the 2 columns as described and defined are summing the same data….

- Column (070) should be equal to the "Position not suitable for exemption" from the previous template (over capitalization and operational position)
- And should be therefore equivalent to the Net Open Position – Exempted SOP already reported in column (050)

Additional Observations

We would like to raise the following point in relation to paragraph 52 of the consultation paper.

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.

We would request the removal of this stipulation as the lack of ability to waive higher order greeks, limits the hedging strategy of the Institution to linear instruments since the potential RWA relief from Delta could be offset by additional RWA stemming from Delta +.

Moreover, for Institutions for which 325b is granted, the short position that the bank might undertake to hedge the excess capital stemming from participation in non-EUR countries is automatically reducing the capital ratio volatility via netting. Hence, the benefit of waiver would follow from waiving Delta +.

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