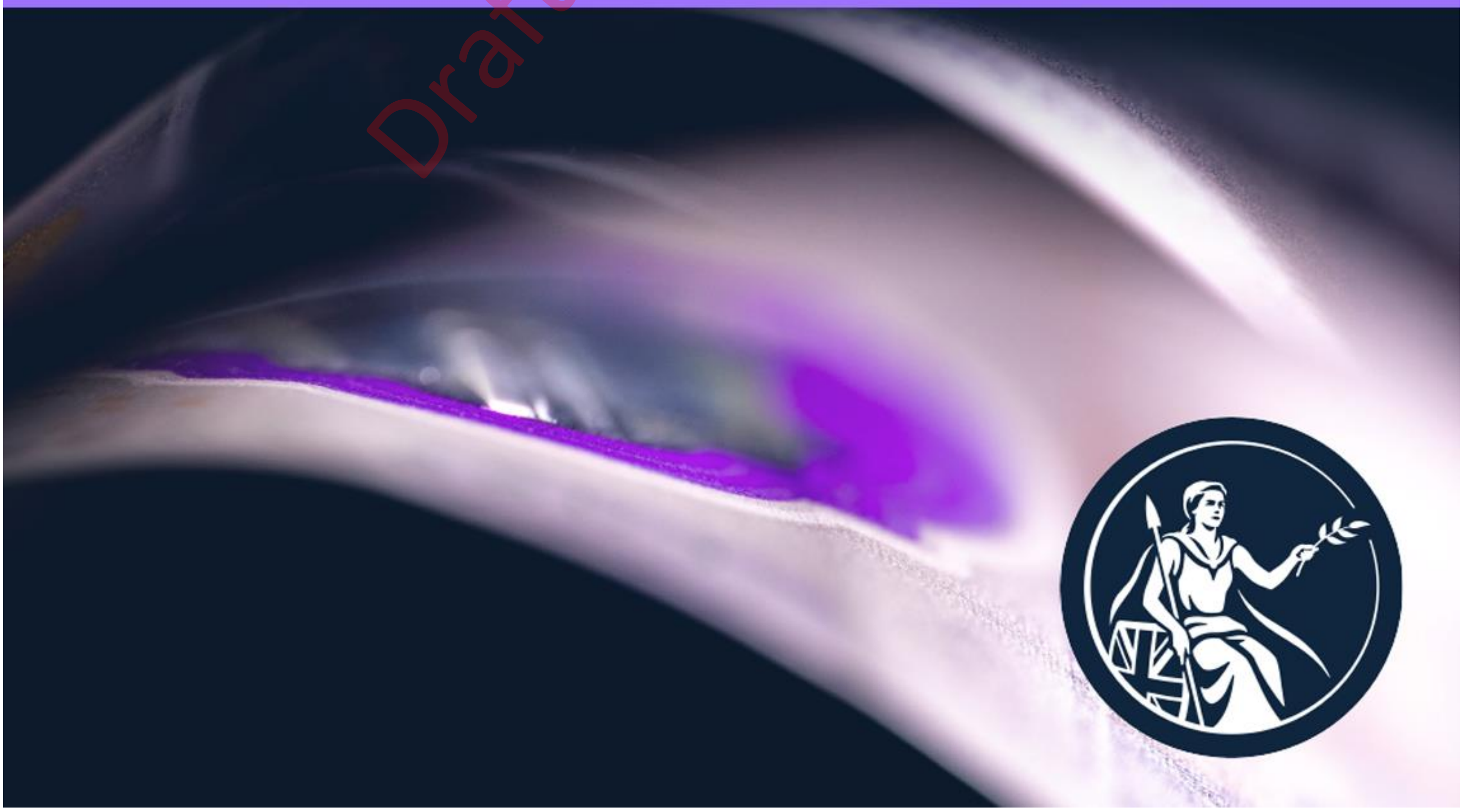
Bank of England PRA

Appendices to CP17/23 – Capitalisation of foreign exchange positions for market risk

September 2023



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Prudential Regulation Authority | 20 Moorgate | London EC2R 6DA

1: Draft amendments to the proposed Article 325 of the Market Risk: General Provisions (CRR) Part of the PRA Rulebook

PRA RULEBOOK: CRR FIRMS: MARKET RISK GENERAL PROVISIONS (CRR) INSTRUMENT 2023

Powers exercised

A. The Prudential Regulation Authority ("PRA") makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):

(1) section 137G (The PRA's general rules);
(2) section 137T (General supplementary powers);
(3) section 144G(1) (Disapplication or modification of CRR rules in individual cases);
(4) section 144H(1) and (2) (Relationship with the CRR);
(5) section 192XA (Rules applying to holding companies); and
(6) section 192XC (Disapplication or modification of rules in individual cases).

B. The rule-making powers referred to above are specified for the purpose of section 138G(2) (Rule-making instrument) of the Act.

PRA Rulebook: CRR Firms: Market Risk General Provisions (CRR) Instrument 2023

C. The PRA makes the rules in the Annex to this instrument.

Commencement

D. This instrument comes into force on [DATE].

Citation

E. This instrument may be cited as the PRA Rulebook: CRR Firms: Market Risk General Provisions (CRR) Instrument 2023.

By order of the Prudential Regulation Committee
[DATE]

Annex

Amendments to the Market Risk: General Provisions (CRR) Part

The changes being consulted on in this CP are changes to wording of proposed rules consulted on in Implementation of the Basel 3.1 standards – CP16/22. Those changes are shown highlighted yellow and underlined (new text) and struck through (deleted text). The use of ellipses denotes the location of proposed rules consulted on in CP 16/22 which are not being consulted on in this CP.

4 GENERAL PROVISIONS (PART THREE, TITLE IV, CHAPTER 1 CRR)

ARTICLE 325 APPROACHES FOR CALCULATING THE OWN FUNDS REQUIREMENTS FOR MARKET RISK

...

9. Any risk positions which an institution uses to hedge against the adverse effect of foreign exchange rates on any of its capital ratios in accordance with Required Level of Own Funds (CRR) Part Article 92 may be excluded by an institution from the calculation of own funds requirements for foreign exchange risk set out in paragraph 1 of this Article, with the prior permission of the *PRA* to the extent and subject to any modifications set out in the permission if, on applying for such permission, an ~~institute~~ <u>institution</u> is able to demonstrate to the satisfaction of the *PRA*:

    (a) the risk positions are deliberately taken or maintained for the purpose of hedging partially or totally against the potential that changes in foreign exchange rates could have an adverse effect on its capital ratios;

    (b) the risk positions are of a non-dealing or structural nature;

    (c) the amount of the risk position excluded is limited to the amount that neutralises the sensitivity of the capital ratio to movements in foreign exchange rates;

    (d) the risk positions are excluded from the calculation of own funds requirements for at least six months;

    (e) the risk positions excluded are established and managed in accordance with a clear risk management policy that the *PRA* has approved; ~~and~~

    (f) the risk positions excluded are documented and can be made available for the *PRA*~~.~~<u>; and</u>

    <u>(g) trading books and non-trading books containing the risk positions excluded are segregated from all other trading activities.</u>

    An institution that has been granted the permission set out in the first sub-paragraph shall comply with the requirements set out in that first sub-paragraph.

    [Note: This is a permission created under sections 144G(2) and 192XC of *FSMA* to which Part 8 of the *Capital Requirements Regulations* applies.]

…

<u>11. In its calculation of own funds requirements for market risk under paragraph 1, an institution shall not include any item which meets all of the following conditions:</u>

<u>(a) the item is not measured at fair value;</u>

<u>(b) the item is subject to the risk of impairment due to foreign exchange risk; and</u>

(c) the item's accounting value is not updated at each of the institution's reporting dates to reflect the changes in the exchange rate between the foreign currency and the reporting currency of the institution recognising the item in its financial statement.

[Note: Paragraphs 1 to 8 of this rule correspond to paragraphs 1 to 8 of Article 325 of *CRR* and paragraph 9 of this rule corresponds to paragraph 2 of Article 352 of *CRR*]

2: Draft amendments to supervisory statement 13/13 – Market Risk

In this appendix, new text is underlined and deleted text is struck through. The text refers to the proposed SS13/13 from CP16/22.

3B Calculation of the overall net foreign exchange position

3B.1 Firms intending to exclude from the calculation of net open currency positions any positions which are taken in order to hedge against the adverse effect of the exchange rate on its ratios in accordance with Article 92(1) of the Required Level of Own Funds (CRR) Part are expected to demonstrate that they meet the requirements for granting the permission under Article 325.9 of the Market Risk: General Provisions (CRR) Part (the 'Structural FX Permission') by providing the PRA with confirmation that they meet the minimum standards set out in Article 325.9 of the Market Risk: General Provisions (CRR) Part. Paragraphs 3B.4~~3~~-3B.12~~9~~ below set out further detail of the PRA's expectations of firms when applying for the SFX Permission. Firms should read CRR Article 325a1 of the Market Risk: General Provisions (CRR) Part before applying for this permission.

3B.2A The PRA expects firms to consider the effects of hedging of capital adequacy ratios at both consolidated and solo levels, and therefore the PRA will generally only consider applications to exclude a position at the level(s) of consolidation for which the position actually hedges the ratios. For example, where a position hedges a firm's consolidated ratios but not the solo-level ratios, the PRA will generally only permit the firm to exclude that position from the calculation of the net position at consolidated level.

Minimum standards

3B.~~3~~ [Deleted] ~~Firms should confirm that the structural foreign exchange (FX) positions are deliberately taken in order to protect capital adequacy ratios against adverse movements in FX rates and are of a non-trading or structural nature.~~

3B.~~7~~ [Deleted] ~~Firms should confirm that books containing structural FX positions are segregated from other trading activities.~~

3B.10. Firms have to calculate their foreign exchange risk positions for market risk capital requirements in accordance with the methodologies referenced in Article 325.1 of the Market Risk: General Provisions (CRR) Part of the PRA Rulebook. However, firms may use an alternative measure for the net FX position when calculated only for the purposes of the SFX permission, as long as they can demonstrate to the PRA's satisfaction that their proposed alternative is a more appropriate measure for hedging capital adequacy ratios against adverse movements in FX rates, and that the proposed alternative does not omit any sources of FX risk that are of a non-trading or structural nature.

3B.11. The PRA expects firms to calculate their maximum risk position per currency *i* using the formula outlined below. Firms may use more complex approaches to determine the maximum risk position, as long as they can demonstrate to the PRA that the alternative approach is an appropriate method of calculation.

$$\begin{aligned} & \mathit{Maximum\ risk\ position\ in\ foreign\ currency\ i} \\ & \quad = \mathit{Sum\ of\ the\ foreign\ currency\ i\ RWAs} \\ & \quad \times \mathit{current\ capital\ ratio\ of\ the\ entity\ hedging\ the\ risk} \end{aligned}$$

3B.12. Firms should at a minimum include their credit risk risk-weighted assets (RWAs) as part of their foreign currency RWAs for the purposes of determining their maximum position per currency *i* in accordance with paragraph 3B.11 above. If firms wish to also include non-credit risk RWAs, they should submit the methodology for including them and their respective sensitivity to movements in FX to be reviewed and agreed by the PRA.

3: Draft amendments to the CRR Permission 352(2) supplementary application form

In this appendix, new text is underlined and deleted text is struck through.

~~CRR Permission 352(2)~~ PRA Rulebook Structural FX supplementary application form

Calculation of the overall net foreign exchange position

Guidance on completion of template:

The template must be completed, together with the CRR permission application form, by a firm applying for permission under Article 325(9) of the Market Risk: General Provisions Part of the PRA Rulebook ~~Article 352(2) permission~~. Firms are expected to fill in both the quantitative and the qualitative parts of the form.

Factors demonstrating that the PRA Rulebook ~~CRR~~ and SS13/13 standards are ~~is~~ met		
PRA Rulebook and SS13/13 ~~CRR~~ Standards	**Meets Standard (Yes/No)**	**Firm Analysis** *Please demonstrate using examples where appropriate how the ~~minimum~~ standards are met*
The proposed hedges are held at the level of consolidation for which the position actually hedges the capital adequacy ratio.		
The overall net FX position of the firm in each currency is calculated as the net delta position in that currency, summing across all positions subject to FX market risk requirements. If the firm uses an alternative measure, please provide details.		
The maximum net risk position is calculated based on the formula proposed in SS13/13.		

The risk-weighted assets (RWAs) used for the calculation of the maximum net open position include at a minimum credit risk RWAs. Please explain whether non-credit risk positions are included as well, and provide details on their inclusion.		
The risk positions are excluded from the calculation of own funds requirements for at least six months.		
The risk positions excluded are established and managed in accordance with a clear risk management policy that the PRA has approved.		
The risk positions excluded are documented and this documentation can be made available to the PRA.		
The risk positions excluded hedge against the adverse effect of foreign exchange rates on the chosen capital adequacy ratio.		
The firm considered the potential losses caused by the SFX risk positions.		

Information regarding SFX risk appetite and management, and proposed exemptions

To support the assessment of the application, the PRA would typically require the following documentation:

Governance

i. SFX risk appetite and approval documentation

ii. SFX management policy

iii. Internal papers / governance related to the application

Risk Management

iv. Hedge effectiveness summary

v. Risk or ALCO reporting showing the information which will be used to manage these exposures and the periodicity

vi. Market risk information:

- which of the positions the firm proposes to exclude from Position Risk Requirements (see Table 1);
- the amount of market risk RWAs the exemption is sought for; and
- an assessment of the potential adverse P&L arising from positions that the firm is seeking to exclude. The analysis should include any FX related cross-risks that the excluded position is sensitive to, along with the materiality of that impact relative to overall capital resources.

vii. Relevant accounting / audit reports

Disclosures

viii. Planned external communication around SFX exposure / capital ratio sensitivity to FX movements

ix. Pillar 3 (Draft) disclosure

Quantitative information regarding structural currency positions

In reporting currency	RWAs	(A) Investment / net asset value (in subs and branches)	i) Borrowings used to manage (A)	ii) Financial instruments used to manage (A)	iii) Other instruments /positions used to manage (A) - please specify[1]	(B) Net open position revaluing to share-holders' equity	Other CET1 capital including deductions	AT1	Tier 2	MREL	Memo: FX rate used to convert into reporting currency
Reporting ccy		-	-	-		-					
Foreign ccy 1		-				-					
Foreign ccy 2		-				-					
...		-				-					
Other		-				-					
Total (Group)		-	-	-		-					

Include all currencies that are material (>5% Risk Weighted Assets and summarise the remaining under 'other').

Please add any additional information / explanation as required, for instance:

- Key assumptions;
- Data quality and aggregation process;
- Relevant accounting aspects (trading book / banking book; regulatory accounting treatment); and
- Further details of AT1, Tier 2, and MREL issuances in foreign currency incl. call dates.

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[1] We recognise firms manage SFX risk in different ways, so please include and comment on other positions / instruments you are using.

Impact on the chosen capital adequacy ratio when the domestic currency depreciates / appreciates

Please indicate which ratio from the Required Level of Own Funds (CRR) Part Article 92 the firm is attempting to protect by the exemption, and quantify the impact on the ratio of individual exchange rates changing by +/-10%. Please complete the analysis for each ratio the firm is planning to protect. Please also provide additional sensitivities if there are non-linear effects.

Capital Adequacy Ratio:

	Ratio without exemption	Impact on ratio with exemption (impact in bps)	
		+10% (strengthening ccy)	-10% (weakening ccy)
Currency 1			
Currency 2			
Currency 3			
…			
Other			

Please comment on other sensitivities/risks if relevant eg whether the currency mix could change significantly for factors outside the firm's control eg a large portion of foreign loans are prepaid/foreign deposits are withdrawn on large scale etc.

Please include pegged or heavily managed currencies in the analysis above and comment separately on your internal assumptions/treatment of those.