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The UK Consults on Clarification of the Requirements for Capitalisation of FX positions

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The UK's Prudential Regulation Authority ("PRA") has published a consultation paper on the 'Capitalisation of foreign exchange positions for market risk' (**CP17/23**). CP17/23 proposes changes to implement upcoming Basel 3.1 requirements for the maintenance of capital against position exposed to FX risks covering:

1. **The treatment of items held at historical FX rates***:* In order to reflect the fact that assets, liabilities or capital currencies held on the balance sheet and using the exchange rate at the time of acquisition are exposed to contingent FX risk and not to daily FX risk, the PRA is proposing to clarify that positions held at historical rates should not be included in the net risk position in Pillar 1 and should be taken account of, and if necessary capitalised as part of the Internal Capital Adequacy Assessment Process Pillar 2 calculations.
2. **Structural FX** *("SFX"):* SFX risk arises when firms hold assets, liability and capital denominated in a currency other than their reporting currency, usually due to having overseas operations. These positions lead to capital ratio volatility as exchange rates move and firms need to translate their risk weighted assets and capital resources into the reporting currency. SFX risk is managed by matching movements in values of foreign currency risk weighted assets to movements in the value of risk positions to achieve broad correlation. Firms are already permitted to apply for permission from the PRA to exempt risk positions that stabilise capital adequacy ratios and the PRA proposes to maintain this SFX Permission but clarify it and make clearer what firms are required to demonstrate in order to exclude positions meant to hedge capital adequacy ratios. Firms will also now be required to segregate SFX positions from trading activities (this is currently an expectation in Supervisory Statement 13/13).
3. **Pillar 1 FX risk calculations and SFX mitigations***:* The PRA is proposing further clarification and specifications for Pillar 1 calculations, including

clarification of the expectation that firms should apply to exclude the SFX position at the consolidation level for which the position hedges the ratios in order to adequately capitalise the FX risk at entity level.

Responses to CP17/23 are due by 31 January 2024.
