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date of receipt: 6 July 2015  
To: Mr Jeppe TRANHOLM-MIKKELSEN, Secretary-General of the Council of  
the European Union

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Subject: ESRB Recommendation on US dollar denominated funding of credit  
institutions (ESRB/2011/2)  
*- Follow-up report - Overall assessment*

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Delegations will find attached the Follow-up Report - Overall assesment - in relation to  
Recommendation ESRB/2011/2.

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Encl.: [...]

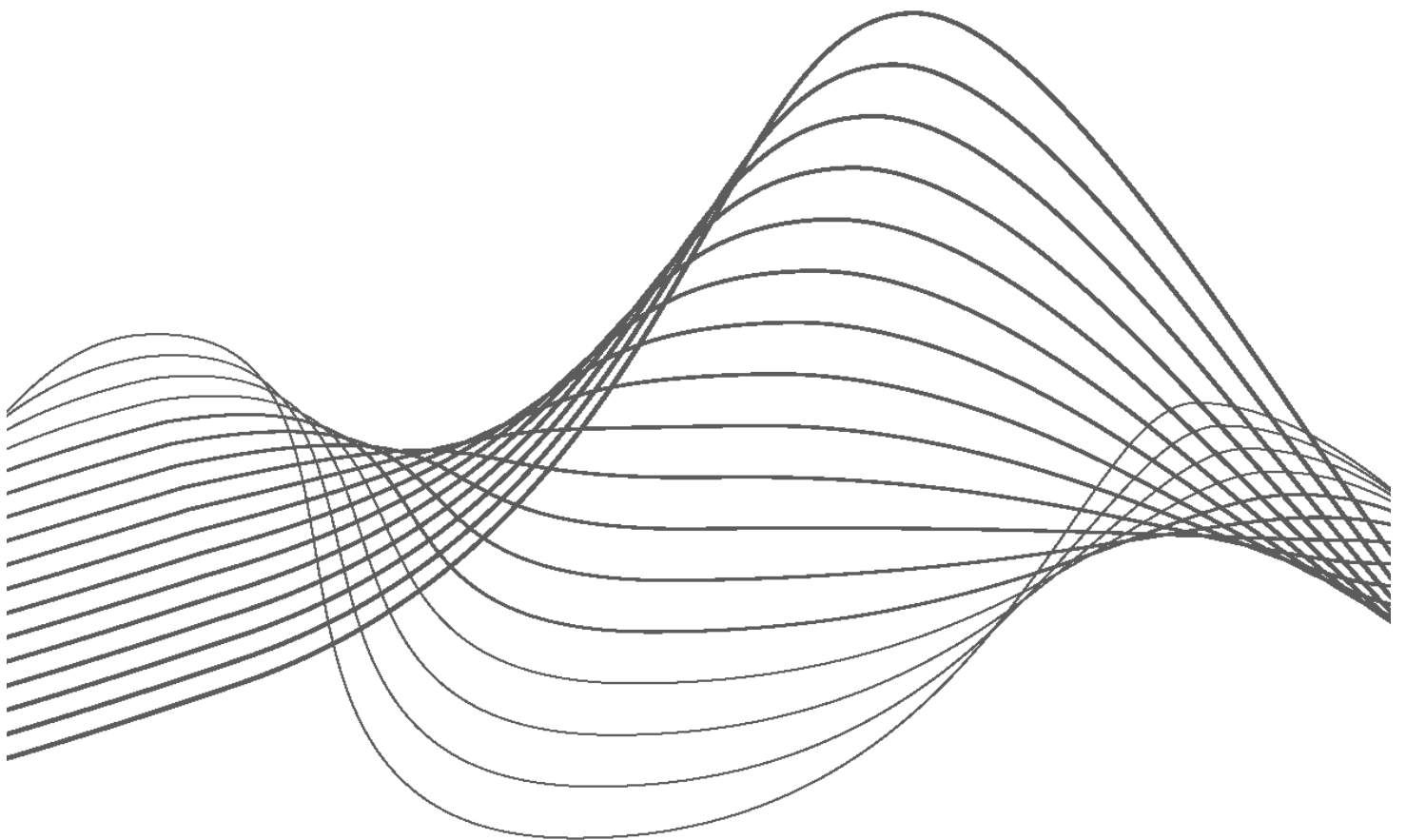
**ESRB Recommendation  
on US dollar denominated  
funding of credit  
institutions (ESRB/2011/2)**

March 2015

**Follow-up report –  
overall assessment**



**ESRB**  
European Systemic Risk Board  
European System of Financial Supervision





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## Abbreviations

### Abbreviations used in tables

FC	fully compliant
LC	largely compliant
PC	partially compliant
MN	materially non-compliant
NC	non-compliant
SE	inaction sufficiently explained
IE	inaction insufficiently explained

### Countries

BE	Belgium
BG	Bulgaria
CZ	Czech Republic
DK	Denmark
DE	Germany
EE	Estonia
IE	Ireland
GR	Greece
ES	Spain
FR	France
HR	Croatia
IT	Italy
CY	Cyprus
LV	Latvia
LT	Lithuania
LU	Luxembourg
HU	Hungary
MT	Malta
NL	Netherlands
AT	Austria
PL	Poland
PT	Portugal
RO	Romania
SI	Slovenia
SK	Slovakia
FI	Finland
SE	Sweden
UK	United Kingdom

### Institutions

ECB	European Central Bank
ESRB	European Systemic Risk Board
NSA	National supervisory authority



## Introduction

This report provides an assessment of the implementation of the European Systemic Risk Board's Recommendation on US dollar denominated funding of credit institutions<sup>1</sup> (hereafter, the "ESRB Recommendation") by the national supervisory authority (NSA) of each EU Member State.

The deadline for the NSAs to provide information on the level of implementation was 30 June 2012. In order to take into account the intensity of the implementation activity in some countries, additional information on the implementation process was collected from the addressees on a voluntary basis during the assessment process via the Advisory Technical Committee (ATC) consultation in October 2014.

This report presents (1) the objective of the ESRB Recommendation, (2) the methodology used by the assessment team, (3) a colour shade table showing individual addressees' results, and (4) a more detailed description of the level of implementation.

<sup>1</sup> ESRB/2011/2 of 22 December 2011, OJ C 72, 10.3.2012, p. 1.



## 1. Objective of the ESRB Recommendation and US dollar funding risks

Banks' US dollar-denominated funding played an important role in the recent financial crisis. Debt denominated in US dollars mainly attracted wholesale funds from US money market mutual funds and was typically a cheap source of financing for EU banks. As the financial crisis in 2007-11 showed, such funds generate immense systemic risks. First, the US dollar-denominated liabilities of EU credit institutions were typically of short duration. Second, there is an underlying risk of sudden and material withdrawal of funding by money market mutual funds, since these US-domiciled funds exhibit a home bias, especially in distressed times when funding is most needed. Third, the banks' business model implies a structural maturity mismatch and thus relies on foreign exchange swap markets, which are likely to dry up precisely when they are most needed. Recommendation ESRB/2011/2 on US dollar denominated funding of credit institutions is thus aimed at avoiding a situation in any potential future financial crisis where tensions arise in the US dollar funding of EU credit institutions that are comparable to those seen in the financial crisis of 2007-11.

For this purpose the ESRB Recommendation advises the NSAs, in recommendation A, to monitor US dollar funding and liquidity risks taken by credit institutions, to encourage them to manage these risks, and to limit their exposures. In recommendation B, it advises them to ensure that credit institutions provide for management actions in their contingency funding plans and to assess the feasibility of these management actions. More precisely, the *National Supervisory Authorities are recommended to*

- (A1) Closely monitor US dollar funding and liquidity risks taken by credit institutions; in particular monitor:
  - (a) maturity mismatches in USD,*
  - (b) funding concentrations by counterparty type, with a focus on short-term counterparties,*
  - (c) use of USD currency swaps (including currency interest rate swaps),*
  - (d) intra-group exposures;**
- (A2) Consider, before exposures to the funding and liquidity risk in USD reach excessive levels:
  - (a) encouraging credit institutions to take action to manage risks arising from maturity mismatches in USD appropriately*
  - (b) limiting the exposures, while avoiding a disorderly unwinding of current financing structures.**
- (B1) Ensure that credit institutions provide for management actions in their contingency funding plans for handling a shock in USD funding, and that those credit institutions have considered the feasibility of those actions if more than one credit institution tries to undertake them at the same time. At a minimum, contingency funding plans should consider the contingency funding sources available in the event of a reduction in supply from different counterparty classes;*
- (B2) Assess the feasibility of these management actions in the contingency funding plans at the level of the banking sector. If simultaneous action by credit institutions is assessed as likely to create potential systemic risks, national supervisory authorities are recommended to consider action to diminish those risks and the impact of those actions on the stability of the Union banking sector.*



As per Article 17 of Regulation (EU) No 1092/2010,<sup>2</sup> verification of the implementation of the ESRB Recommendation was carried out following the “act or explain” mechanism, where the addressee of a recommendation can either (i) take action in response to a recommendation and inform the ESRB of such action, or (ii) take no action provided that it can properly justify the reasons for inaction. The ESRB subsequently analyses the information provided and verifies whether the actions taken duly achieve the objective of the recommendation or whether the justification provided for inaction is sufficient. This analysis results in a final grade being assigned to each addressee.

## 2. Methodology

The follow-up report has been prepared on the basis of addressees’ own submissions to the ESRB Secretariat, i.e. responses to a set questionnaire covering each recommendation. The assessment is based on the methodology provided in the “Handbook on the follow-up to ESRB Recommendations”.<sup>3</sup>

For quality assurance purposes, a twofold approach was applied: the assessment team was divided into two groups, with the first conducting its analysis of implementation on a horizontal basis (i.e. by addressee) and the second following a vertical approach (i.e. focusing on recommendation). The results of the two groups were then cross-checked for the preparation of the final version of the report. The grading structure followed is provided in the table below, which uses colour coding for improved readability.

**Table 1 Grading structure**

Positive grades	Mid-grade	Negative grades
<b>Fully compliant (FC)</b> – Actions taken fully implement the recommendation		<b>Materially non-compliant (MN)</b> – Actions taken only implement a small part of the recommendation
<b>Largely compliant (LC)</b> – Actions taken implement almost all of the recommendation	<b>Partially compliant (PC)</b> – Actions taken only implement part of the recommendation	<b>Non-compliant (NC)</b> – Actions taken are not in line with the nature of the recommendation
<b>Inaction sufficiently explained (SE)</b> – No actions were taken but the addressee provided sufficient justification		<b>Inaction insufficiently explained (IE)</b> – No actions were taken and the addressee did not provide sufficient justification

<sup>2</sup> Regulation (EU) No 1092/2010 of the European Parliament and of the Council of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board, OJ L 331, 15.12.2010, p. 1.

<sup>3</sup> Available in the “Publications” section of the ESRB’s website (<https://www.esrb.europa.eu>).



The grades assigned for the level of implementation of each sub-recommendation was then translated into a numerical value on the basis of the following tables:

**Table 2A Conversion table for individual grades (action)**

Individual grades	
FC	1
LC	0.75
PC	0.5
MN	0.25
NC	0

**Table 2B Conversion table for individual grades (inaction)**

Individual grades	
SE	0.75
IE	0

Finally, the overall grade was derived by calculating the weighted average of the grades assigned for each sub-recommendation, together with the proportion of the sub-recommendation grades that stemmed from action/inaction, and comparing them against Table 3A. Thus the overall grade is obtained by applying two criteria.

**Table 3A Conversion table for overall grades**

Overall grade	
FC	<0.9; 1> and >50% of weighted grades are action
LC	<0.65; 0.9) and >50% of weighted grades are action
PC	<0.4; 0.65) and >50% of weighted grades are action
MN	<0.15; 0.4) and >50% of weighted grades are action
NC	<0; 0.15) and >50% of weighted grades are action
SE	<0.65; 0.875> and ≥50% of weighted grades are inaction
IE	<0; 0.65) and ≥50% of weighted grades are inaction

For instance, the overall grade “inaction sufficiently explained” was assigned when at least 50% of the weighted grades for individual sub-recommendations stemmed from inaction, and the total average grade was between 0.65 and 0.875 (inclusive). The overall grade “inaction insufficiently explained” was given when at least 50% of the weighted grades for individual sub-recommendations stemmed from inaction, and the total overall grade was less than 0.65.





The assessment team decided to assign weights to the sub-recommendations as follows:

**Table 3B Weights of the sub-recommendations**

Composition of overall grade	
A1(a)	10%
A1(b)	10%
A1(c)	10%
A1(d)	10%
A2(a)	10%
A2(b)	10%
B1	20%
B2	20%

Many countries have not implemented the measures contained in the ESRB Recommendation but rather provided a justification for their lack of action. A common argument in this respect was that the US dollar was not a material currency. In order to ensure consistency, the assessment team adopted a materiality threshold as defined in Article 415 of Regulation (EU) 575/2013 and applied this number to the aggregate banking sector. Thus the US dollar is regarded as a material currency at the macroeconomic level whenever the ratio of US dollar funding to total funding exceeds the threshold of 5% in the aggregate banking sector.

<sup>4</sup> Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms, OJ L 176, 27.6.2013, p. 1.



### 3. Colour shade table – individual addressees' results

The table below shows the overall implementation level for the ESRB Recommendation in each country, with the overall grades for recommendation A and recommendation B as well as a detailed picture of the compliance level for each sub-recommendation.

**Table 4 Individual country results**

Addressees	Sub-recommendations								Overall grade
	A1				A2		B1	B2	
	(a)	(b)	(c)	(d)	(a)	(b)			
Belgium	FC	FC	FC	FC	SE	SE	FC	LC	FC
Bulgaria	LC	LC	PC	LC	SE	SE	PC	SE	LC
Czech Republic	SE	SE	SE	SE	SE	SE	SE	SE	SE
Denmark	FC	LC	FC	FC	FC	FC	FC	FC	FC
Germany	FC	FC	FC	FC	FC	FC	FC	FC	FC
Estonia	FC	FC	FC	LC	FC	FC	FC	FC	FC
Ireland	LC	LC	LC	LC	SE	SE	PC	PC	LC
Greece	SE	SE	SE	SE	SE	SE	SE	SE	SE*
Spain	FC	FC	FC	FC	FC	FC	FC	SE	FC
France	FC	FC	FC	FC	FC	SE	FC	FC	FC
Croatia	SE	SE	SE	SE	SE	SE	SE	SE	SE
Italy	FC	FC	FC	FC	FC	FC	FC	SE	FC
Cyprus	SE	PC	PC	PC	FC	FC	FC	PC	LC
Latvia	FC	LC	FC	SE	FC	FC	FC	LC	FC
Lithuania	FC	SE	SE	SE	SE	SE	FC	SE	SE
Luxembourg	FC	FC	FC	FC	FC	FC	FC	FC	FC
Hungary	SE	SE	SE	SE	SE	SE	SE	SE	SE
Malta	FC	FC	FC	FC	FC	FC	FC	FC	FC
Netherlands	FC	FC	FC	FC	FC	FC	FC	FC	FC
Austria	FC	FC	FC	FC	FC	LC	FC	LC	FC
Poland	FC	FC	FC	FC	FC	FC	FC	SE	FC
Portugal	FC	SE	SE	FC	SE	SE	SE	SE	SE
Romania	SE	SE	SE	SE	SE	SE	SE	SE	SE
Slovenia	SE	SE	SE	SE	SE	SE	SE	SE	SE
Slovakia	SE	SE	SE	SE	SE	SE	SE	SE	SE
Finland	FC	FC	FC	FC	FC	FC	FC	FC	FC
Sweden	FC	FC	FC	FC	FC	FC	FC	LC	FC
United Kingdom	FC	FC	FC	FC	FC	FC	FC	LC	FC

\* The Greek authorities have implemented some measures although the US dollar is not a material funding currency. However, these measures would overall only be partially compliant with the ESRB Recommendation.

The table indicates that 16 addressees have fully implemented the ESRB Recommendation. Bulgaria, Ireland and Cyprus have followed the ESRB Recommendation to a large degree. In all three countries US dollar funding exceeds the 5% threshold. However, this is predominantly in



retail and corporate deposits rather than US dollar wholesale funding. Nine countries have not implemented the measures contained in the ESRB Recommendation but provided justification that is considered sufficient.

#### 4. Overall level of implementation of the ESRB Recommendation

The following sections provide more details about the level of implementation of each sub-recommendation contained in the Recommendation.

##### 4.1. Level of implementation of recommendation A

Recommendation A requires the NSAs to monitor US dollar funding and liquidity risks taken by credit institutions, to encourage them to manage these risks, and to limit their exposures. Sub-recommendation A1 requires NSAs to monitor US dollar funding and liquidity risks, including a) maturity mismatches in US dollars, b) funding concentrations by counterparty type, c) US dollar currency swaps, and d) intra-group exposures. Sub-recommendation A2 recommends considering, before exposure to US dollar risk becomes excessive, a) encouraging appropriate management of US dollar risk, and b) limiting exposures.

##### 4.1.1 Level of implementation of sub-recommendation A1(a)

Eighteen Member States have fully implemented this sub-recommendation, with Bulgaria and Ireland assessed as largely compliant. Eight Member States have not implemented additional measures to monitor maturity mismatches in US dollars.

**Table 5 Grades assigned to each Member State for implementation of sub-recommendation A1(a)**

Fully compliant	Largely compliant	Inaction sufficiently explained
BE, DK, DE, EE, ES, FR, IT, LV, LT, LU, MT, NL, AT, PL, PT, FI, SE and UK	BG and IE	CZ, GR, HR, CY, HU, RO, SI and SK

##### 4.1.2 Level of implementation of sub-recommendation A1(b)

A1(b) has also been fully or largely implemented by the majority of the addressees. Cyprus was assessed as partially compliant in monitoring funding concentrations by counterparty type.

**Table 6 Grades assigned to each Member State for implementation of sub-recommendation A1(b)**

Fully compliant	Largely compliant	Inaction sufficiently explained	Partially compliant
BE, DE, EE, ES, FR, IT, LU, MT, NL, AT, PL, FI, SE and UK	BG, DK, IE and LV	CZ, GR, HR, LT, HU, PT, RO, SI and SK	CY

##### 4.1.3 Level of implementation of sub-recommendation A1(c)

Monitoring of US dollar currency swaps has been fully or largely implemented by 17 Member States, while Bulgaria and Cyprus have only partially implemented this sub-recommendation.



**Table 7 Grades assigned to each Member State for implementation of sub-recommendation A1(c)**

Fully compliant	Largely compliant	Inaction sufficiently explained	Partially compliant
BE, DK, DE, EE, ES, FR, IT, LV, LU, MT, NL, AT, PL, FI, SE and UK	IE	CZ, GR, HR, LT, HU, PT, RO, SI and SK	BG and CY

#### 4.1.4 Level of implementation of sub-recommendation A1(d)

Similarly to the sub-recommendations A1(a) and (b), A1(d) has also been fully or largely implemented by the majority of the addressees. Cyprus was assessed as partially compliant in monitoring intra-group exposures.

**Table 8 Grades assigned to each Member State for implementation of sub-recommendation A1(d)**

Fully compliant	Largely compliant	Inaction sufficiently explained	Partially compliant
BE, DK, DE, ES, FR, IT, LU, MT, NL, AT, PL, PT, FI, SE and UK	BG, EE and IE	CZ, GR, HR, LV, LT, HU, RO, SI and SK	CY

#### 4.1.5 Level of implementation of sub-recommendation A2(a)

Sixteen Member States are fully compliant with this sub-recommendation, i.e. to encourage appropriate management of US dollar risks, whereas 12 Member States took no action.

**Table 9 Grades assigned to each Member State for implementation of sub-recommendation A2(a)**

Fully compliant	Inaction sufficiently explained
DK, DE, EE, ES, FR, IT, CY, LV, LU, MT, NL, AT, PL, FI, SE and UK	BE, BG, CZ, IE, GR, HR, LT, HU, PT, RO, SI and SK

#### 4.1.6 Level of implementation of sub-recommendation A2(b)

Sub-recommendation A2(b) is that exposures in US dollar funding be limited before they become excessive. Only very few countries have imposed a limit specifically on US dollar funding and have therefore been graded as fully compliant (Latvia, the Netherlands, Poland and Sweden). Other countries state explicitly that the authority has the capacity to impose limits on funding and liquidity risk exposures in US dollars, but the monitoring of liquidity risks has not shown the actual imposition of limits to be necessary. Those addressees have also been graded fully compliant. The measures taken in Austria have been assessed to be largely compliant, with minor discrepancies. The Austrian authorities have monitored banks with vulnerable exposures to US dollar funding and implemented a soft measure in the form of an intense communication with the banks, but have not explicitly defined a strict limit.

**Table 10 Grades assigned to each Member State for implementation of sub-recommendation A2(b)**

Fully compliant	Largely compliant	Inaction sufficiently explained
DK, DE, EE, ES, IT, CY, LV, LU, MT, NL, PL, FI, SE and UK	AT	BE, BG, CZ, IE, GR, FR, HR, LT, HU, PT, RO, SI and SK



#### 4.2. Level of implementation of recommendation B

Recommendation B requires the NSAs to ensure that credit institutions provide for management actions in their contingency funding plans and to assess the feasibility of these management actions.

##### 4.2.1 Level of implementation of sub-recommendation B1

Sub-recommendation B1 requires the NSAs to ensure that credit institutions have management actions with respect to US dollar funding in their contingency funding plans. Most addressees have fully complied with this sub-recommendation. Only two countries have been given a lower grade. The Bulgarian authorities regard the US dollar as an immaterial currency, although the ratio of liabilities denominated in US dollars to total liabilities exceeds the materiality threshold of 5%. The measures that are currently in place through Ordinance No 11 of Българска народна банка (Bulgarian National Bank) are only partially compliant with the measures contained in the ESRB Recommendation. In Ireland, banks are required to have contingency plans in place to identify and deal with any liquidity problem. However, such plans are not required on a currency-specific level. All remaining countries provided a sufficient explanation for their inaction.

**Table 11 Grades assigned to each Member State for implementation of sub-recommendation B1**

Fully compliant	Inaction sufficiently explained	Partially compliant
BE, DK, DE, EE, ES, FR, IT, CY, LV, LT, LU, MT, NL, AT, PL, FI, SE and UK	CZ, GR, HR, HU, PT, RO, SI and SK	BG and IE

##### 4.2.2 Level of implementation of sub-recommendation B2

Sub-recommendation B2 requires NSAs to assess the feasibility of the contingency funding plans at a system-wide level. This sub-recommendation has been fully implemented by only 8 Member States, 5 have been assessed as largely and 2 as partially compliant. The Cypriot national authority reported, as part of its enhancements to liquidity regulations in 2012, some guidance on adequate contingency funding plans for which no reports on planned action to assess the USD-specific contingency funding plans are available.

**Table 12 Grades assigned to each Member State for implementation of sub-recommendation B2**

Fully compliant	Largely compliant	Inaction sufficiently explained	Partially compliant
DK, DE, EE, FR, LU, MT, NL and FI	BE, LV, AT, SE and UK	BG, CZ, GR, ES, HR, IT, LT, HU, PL, PT, RO, SI and SK	IE and CY



## Conclusion

The most noteworthy outcome of the assessment is that most addressees have fully implemented the ESRB Recommendation. However, the assessment has also shown that the US dollar is not a material currency for some Member States, and these countries have not implemented the Recommendation, referring to the principle of proportionality.<sup>5</sup>

If only the Member States where action has been taken are considered, the overall level of implementation is high, with 16 of these countries being graded fully and three largely compliant. In general, the ESRB Recommendation has been successful in establishing an early warning system for increasing risks from developments in US dollar funding. However, while the overall result is positive, further improvements are still possible and certainly recommended. In conclusion, the following issues must be highlighted:

- NSAs in Member States where exposure to US dollar funding is currently material should further monitor US dollar funding at the institutional level;
- NSAs which do not consider the US dollar as a material currency should nonetheless continue to monitor the significance of US dollar funding in their banking sectors on a regular basis;
- NSAs in Member States with higher exposure to US dollar funding should consider imposing appropriate limits, since the vulnerabilities stemming from the structure of bank funding could become problematic in the event of the funding sources rapidly disappearing;
- the ECB, as a competent authority, should also follow this recommendation, in particular by monitoring US dollar funding and by ensuring that credit institutions provide for management actions in their contingency funding plans as well as by assessing the feasibility of these management actions.

**Table 13 Overall grades assigned to each Member State for implementation of the Recommendation**

Fully compliant	Largely compliant	Inaction sufficiently explained
BE, DK, DE, EE, ES, FR, IT, LV, LU, MT, NL, AT, PL, FI, SE and UK	BG, IE and CY	CZ, GR, HR, LT, HU, PT, RO, SI and SK

<sup>5</sup> Note that the assessment team adopted a materiality threshold, as defined in Article 415 of Regulation (EU) 575/2013, such that the US dollar is regarded as a material currency whenever the ratio of US dollar funding to total funding exceeds the threshold of 5% in the aggregate banking sector.