

The logo for the European Banking Authority (EBA) is located in the top left corner. It consists of the letters 'EBA' in a large, white, sans-serif font. To the right of the letters, the words 'EUROPEAN BANKING AUTHORITY' are written in a smaller, white, sans-serif font, stacked vertically. The logo is set against a dark blue background with a vertical orange stripe on the left side.

EBA

EUROPEAN
BANKING
AUTHORITY

Public hearing – Consultation on interest rate risk in the banking book (IRRBB) and credit spread risk in the banking book (CSRBB)

3 March 2022

Suggestions for an efficient session

- Should you need **assistance** or would like to **intervene**:
 1. **write on WebEx chat** to any of the hosts or publicly;
 2. or, **raise your hand on WebEx**.
- **To avoid background noise**, please **stay muted**  unless you take the floor.
- To increase audio quality please turn off video streaming.
- **Please identify yourself** (if you do not use full name on WebEx).
- For the **Q&A session**, please **write on the WebEx chat your name and the topic you would comment on for taking the floor** for a question.

Background (1 of 3)



- **Current 2018 EBA Guidelines (GL) on IRRBB** already envisage specific provisions as regards IRRBB internal measurement systems (IMS), a preliminary definition of CSRBB and specific criteria for the EVE SOT (supervisory outlier test), including the detailed description of the shock scenarios upon which to run this SOT.

- **CRD mandates:**
 - Article 84 (6) CRD – EBA Guidelines (GL) on IRRBB and CSRBB.
 - Article 84(5) CRD – EBA draft regulatory technical standards (RTS) on a standardised methodology (SA) and simplified standardised methodology (sSA).
 - Article 98(5)(a) CRD – EBA draft RTS on supervisory outlier tests (SOTs)

- With these GL and RTS the implementation of the **Basel IRRBB rules in the EU** will be finalised.

Background (2 of 3)



- The EBA published the **consultation papers** on the draft RTS and draft GL on 2 December 2021. Feedback is expected until 4 April 2022.
- The **IRRBB and CSRRBB Guidelines** seek to specify the criteria for IRRBB identification, management and mitigation. They also need to specify the criteria for IRRBB evaluation under IMS as well as to assess and monitor CSRRBB. They will also provide criteria for the identification of IMS that are not “satisfactory”. The current 2018 EBA GL will be repealed after their entry into force.
- The **RTS on a standardised methodology** will specify how to evaluate IRRBB, from an (economic value of equity) EVE and (net interest income) NII perspective, that banks may use alternatively to own IMS or supervisors may require if IMS are not “satisfactory”. They will also specify a simplified standardised methodology for small and non-complex institutions (SNCI).

Background (3 of 3)



- The **RTS on SOTs** seek to specify common modelling and parametric assumptions and supervisory shock scenarios as well as the definition of a large decline in the NII, in the context of EVE and NII SOTs.

To recall, implications of SOTs thresholds (Article 98(5) CRD):

In the context of the supervisory review and evaluation process (SREP), supervisory powers (including requirement of additional own funds, reinforcement of arrangements, process... or by specifying other modelling and parametric assumption than those established in the RTS) shall be exercised in case of decline of EVE or NII beyond the thresholds specified in the CRD (Capital Requirements Directive) and the RTS on SOTs.

However, competent authorities shall not be obliged to exercise supervisory powers if they consider that the institution's IRRBB management is adequate and that the institution is not excessively exposed to IRRBB.

Agenda



- CP on draft RTS on IRRBB supervisory outlier tests
- CP on draft GL on IRRBB and CSRBB
- CP on draft RTS on IRRBB standardised approach
- Next steps
- Q&As

SOTs – Key aspects considered (1 of 3)



SOT on EVE: Basel, EBA GL and some recalibration of the lower bound of post-shock interest rates.

SOT on NII: New. Main aspects:

- Determination of elements in the net interest income: **NII versus Earnings**.
 - Interest income, interest expenses, fair value changes, fees, commissions...
- **Aspects considered:**
 - Accounting vs profitability perspective (forward looking, modelled risk)
 - IR Fundamentals vs operational feasibility and standardisation
 - Basel, EBA GL
- **Metrics to define a “large decline”** (risk to maintain normal business) to identify outliers:
 - Capital related metric: Focus on shocked NII change as a % of capital
 - Income/expense related metric: Focus on Impact of a shock on NII to cover administrative expenses
- **Calibration of outlier thresholds** with the QIS. Similar degree of severity to the EVE SOT in the CRD

SOTs - Draft RTS – Main modelling and parametric assumptions (2 of 3)



- **RTS (for SOT on NII):**
 - Time horizon: 1year
 - Scenarios 1 and 2 (parallel shock up and down) in the current EBA IRRBB GL.
 - Commercial margins and spread components included
 - A constant balance sheet

- **RTS (for SOT on EVE):**
 - The six supervisory shock scenarios in the current EBA IRRBB GL.
 - Run-off balance sheet assumption
 - Own funds excluded

- **RTS (for SOT on NII and EVE):**
 - Revised post-shock lower bound IR (-150bp and 3bp/year increase).
 - Currency aggregation: Generally, 50% applies on the gains and a 100% on the losses. Exception: 80% to apply on gains if European Exchange Rate Mechanism II (ERM II) currencies to offset losses in EUR.

- ***Subsequently: IMS or SA assumptions will apply for SOTs if not specified in the RTS on SOTs.***

SOTs - Draft RTS SOT on NII – Large decline (3 of 3)

- Definition and calibration of the **large decline in the SOT on NII**:

- **Metric 1: $\Delta NII / Tier 1 < x$** , where:

- ▶ $x = -2.5\%$, if NII does not include fair value changes;
- ▶ $x = -3.0\%$, if NII includes fair value changes

- **Metric 2: $\frac{NII_{shock} - \alpha \cdot AdmExpens}{NII_{baseline} - \alpha \cdot AdmExpens} - 1 < x$** , where

- ▶ $x = -35\%$, if NII does not include fair value changes;
- ▶ $x = -30\%$ if NII includes fair value changes.

$$\alpha = \frac{NII_{hist}}{Operating\ income}$$

NII shock and NII baseline are the NII under any of the supervisory shock scenarios and NII under the baseline scenario.

Draft Guidelines: New structure (1 of 3)



- A new section on **CSRBB** is added separate to **IRRBB** sections.
- A new section on the criteria to assess **IMS as not satisfactory**.
- **SOT related items will be removed** and captured in the RTS on SOT.
- **Annex I on measurement of IRRBB (IMS) to be kept**. To reinforce they are not restrictive but expected more than one.

Draft Guidelines: IRRBB (2 of 3)



- **General continuation** of current 2018 EBA GL.
- Proposal for a consistent **determination of net interest income** including interest income, interest expenses and market value changes for the purpose of IRRBB and CSRBB by IMS.
- Proposal of a **five years cap to the repricing maturity of non-maturing deposits (NMDs) from non-financial customers** in the IRRBB evaluation under IMS. Prudent harmonization and unique behavioral assumption.
- Proposal to identify **non-satisfactory IRRBB IMS** as follows:
 - **High level principle:** an IMS is non-satisfactory if IRRBB GL non-compliant.
 - **Some specific (not restrictive) cases** of non-satisfactory IMS:
 - If material components of IRRBB (including gap, basis or option risk) or material exposures to IRRBB are not covered by the measures used.
 - If suboptimal implementation of the minimum required validation, review and control of IRRBB exposures.

Draft Guidelines: CSRBB (3 of 3)

- **Definition** – key aspects
 - Changes in the spread due to market liquidity risk and market credit risk.
 - Price of risk under the same level of creditworthiness.
 - Idiosyncratic elements not included.

- **Perimeter** – key aspects
 - No instrument excluded ex-ante. Banks to demonstrate any exclusion.
 - Assets accounted at fair value should never be excluded (minimum harmonization).

- Some guidance on **Governance** for CSRBB and **general principles for evaluation**.

Standardised Approach - Draft RTS – Key characteristics (1 of 3)



- SA is based on the Basel SA on EVE (2016):
 - Standardised cash flow buckets (and mid-points) apply (19 in total).
 - Institutions estimate behavioural cash flows (prepayments, term deposits, NMDs) based on relevant data, subject to constraints and assumptions.
 - The estimation by the institutions of the key parameters such as proportion of core deposits, the conditional prepayment rate (CPR) and term deposit redemption (TDR) should refer to the baseline interest rate scenario.
 - On core NMDs there are the 90%, 70% and 50% caps on the proportion of core component depending the counterparty category, and caps on average maturity on the core component of 5, 4.5 and 4 years.
 - For the slotting of cash flows under the shock scenarios, scenario-dependent conservatism scalars of 0.8 and 1.2 apply to the behavioural parameters.
 - Proportionality thresholds for immaterial amounts.
 - Discount factors to be calculated from the mid points of each repricing time bucket to calculate EVE.
 - Automatic optionality add-on, including a 25% volatility add-on.

Standardised Approach - Draft RTS – Key characteristics (2 of 3)



- **NII:** Provides a forward-looking projection of interest income with a 1-year horizon or higher. NII requires more steps than EVE and is mainly calculated as sum of:
 - Projected risk-free yields on repricing cash flows from repricing time to end of NII horizon.
 - Projected yield from commercial margins on repricing cash flows from repricing time to end of NII horizon.
 - All interest payments that are already fixed (up to their reset date / repricing date).
- The slotting of repricing cash flows of EVE serves as a basis, complemented by slotting according to original maturity buckets (“reference term”). This is consistent with the constant balance sheet assumption. A matrix of forward rates to be calculated (based on mid points of repricing and reference term time buckets).
- Projected commercial margin based on recent transactions (observed in the last year or based on observable market prices).
- Market value changes of (fair value) FV instruments included where beyond the NII horizon.
- As for EVE, there is an add-on for automatic optionality

Standardised Approach - Draft RTS – Key characteristics (3 of 3)



- Proportionality in **Simplified-SA** for EVE and NII:
 - For NMDs full prescription of proportion of core component and linear slotting. QIS data used to verify conservatism (vs 'normal' SA), with the scalars to be applied to NMDs changed from 0.8&1.2 to 0.7&1.3.
 - Automatic optionality: Reliance on pay-outs (instead of full revaluation), combined with an implied volatility proxy.

- **Basis risk** add-on to delta NII:
 - Comparatively simple and non-prescriptive relying on the slotting of floating rate instruments and estimates of a widening and tightening shock.
 - In addition an add-on to be calculated for automatic options.

Next steps

- 2 December 2021 – **4 April 2022**: Public consultation on:
 - Draft RTS on IRRBB supervisory outlier tests (IRRBB SOTs)
 - Draft RTS on IRRBB standardised approach (IRRBB SA)
 - Draft GL on management of IRRBB and CSRBB

- Process and targets:
 - Finalisation of the **policy work by summer** under the different EBA structures,
 - Final endorsement by the EBA Board of Supervisors,
 - Publication and submission of the draft RTS to the EU Commission,
 - Translation and publication of the GL.

- Application dates: Merit in seeking **coherence between the application date of the GL and the RTS.**

- **EBA will monitor IRRBB** via QIS or potential upcoming ITS on supervisory reporting.

The logo for the European Banking Authority (EBA) is located in the top left corner. It consists of the letters 'EBA' in a bold, white, sans-serif font, set against a dark blue background with a subtle grid pattern. To the right of the letters, the words 'EUROPEAN BANKING AUTHORITY' are written in a smaller, white, sans-serif font, stacked vertically.

EBA

EUROPEAN
BANKING
AUTHORITY

EUROPEAN BANKING AUTHORITY

Floor 24-27, Tour Europlaza
20 Avenue André Prothin
92400 Courbevoie, France

Tel: +33 1 86 52 70 00

E-mail: info@eba.europa.eu

<https://eba.europa.eu/>