Nederlandse Vereniging van Banken

CONSULTATION REACTION

Reaction of the Dutch Banking Association (NVB) on the Guidelines on IRRBB and CSRBB

Date: 1 April 2022

The NVB appreciates the opportunity to respond to EBA's consultation of the GL on IRRBB and CSRBB. As part of the wider pack (the NVB has also reacted on the IRRBB SOTs) , the text below represents the collected feedback by Dutch banks for your further consideration.

Implementation date

First we would like to give a general comment with respect to the implementation date. Although not explicitly stated, article 8 on page 17 of the GL links the implementation date of this GL to those of the RTS on the SOT and SA, being 20 days after the publication in the official journal of the European Union. Considering the wide range of items that are covered in this GL (e.g. policies and changes to IT systems (see article 139) and thus require considerable time to implement), this implementation date is not realistic. The Dutch banks will not be able to comply with these GL in this timeframe. Instead we propose a timeframe of at least 6 months, which would start after the publication in the official journey of the European Union.

Question 1: In the context of the measurement of the impact of IRRBB under internal systems, paragraph 111 envisages a five year cap repricing maturity for retail and non-financial wholesale deposits without a specified maturity. Would you foresee any unintended consequence or undesirable effect from this behavioural assumption in particular on certain business models or specific activities? If this is the case, please kindly provide concrete examples of it.

Response:

Before responding to this question, we refer to article 98.5c of the CRD5 (directive 2019/878 amending directive 2013/36/EU), where the behavioural assumptions are explicitly excluded from the common modelling and parametric assumptions for the purpose of paragraph 5a and 5b (supervisory outlier test for both EVE and NII). Therefore we question whether the EBA has the mandate to impose such a 5Y cap, at least not if it is used for the supervisory outlier test.

- It is clarified in the explanatory box that the 5-year cap applies to the full amount of Non Maturing Deposits (NMD) – as opposed to just core deposits. It would be good to add this clarification also in the regulatory text.

- If the 5-year cap would apply to just the core deposits – as proposed in the draft RTS on the simplified and standardised methodologies (SM) – the resulting effective cap would be considerably more restrictive than current internal modelling assumptions used by banks for NMDs. We consider this a significant limitation and would not favour using the SM structurally for banks using internal models and methodologies.

- While it is clear from the explanatory box that the 5-year cap applies to the combined volume of core and non-core deposits, it remains somewhat ambiguous if the 5-year cap would apply to
    - (a) the aggregate NMD portfolio, or
    - (b) to portfolios individually?

  We suggest to clarify this in the regulatory text. Moreover, we observe that it is not uncommon for retail transactional deposits portfolios to have modelled average maturities beyond 5 years – in line with the nature of this product. Hence, we suggest clarifying that the 5-year cap applies to the aggregate portfolio of modelled non-maturing deposits and not on each portfolio individually. Alternatively, a somewhat higher cap could be considered for retail transactional deposits.

Question 2: Do the correspondents find that the criteria to identify non-satisfactory internal models provide the minimum elements for supervisors' assessment?

Response:

The criteria as mentioned in paragraph 199 are principle based and defined at high level. We can agree with these criteria, in particular that internal models should cover all components (gap risk, basis risk, option risk) and all material dimensions (i.e. all interest sensitive assets, liabilities and off-balance sheet instruments). As these criteria are not further specified, we would like to emphasize that supervisors should not prescribe specific methods or techniques to manage interest rate risk.

As (nearly) all banks use internal models for IRRBB, we have not responded to the consultation on the (simplified) standardized approach. In our view the (S)SA does not capture IRRBB properly. We have assumed that:

- The (S) SA will not be used for benchmarking purposes neither as a sort of minimum requirements for internal models
- In case a supervisor is of the opinion that an institution does not fully comply with all elements for internal models, in particular article 119b, the supervisor starts a dialogue with the institutions to return to compliance rather than imposing the (S)SA.

It would be appreciated, if these assumptions were included in the GL.

Question 3: Is there any specific element in the definition of CSRBB that is not sufficiently clear for the required assessment and monitoring of CSRBB by institutions?

Response:

For CSRBB Basel standards BCBS 368 make a distinction between amortized cost and fair value. It acknowledges that CSRBB is more readily identifiable in traded instruments. Art. 120 follows the split made by the BCBS for items at fair value but ignores the split made for items at amortized costs. This makes that the definition is not clear enough to be fully implemented. We would appreciate, if it is substantiated how evidence to put portfolio's out of scope can be provided.

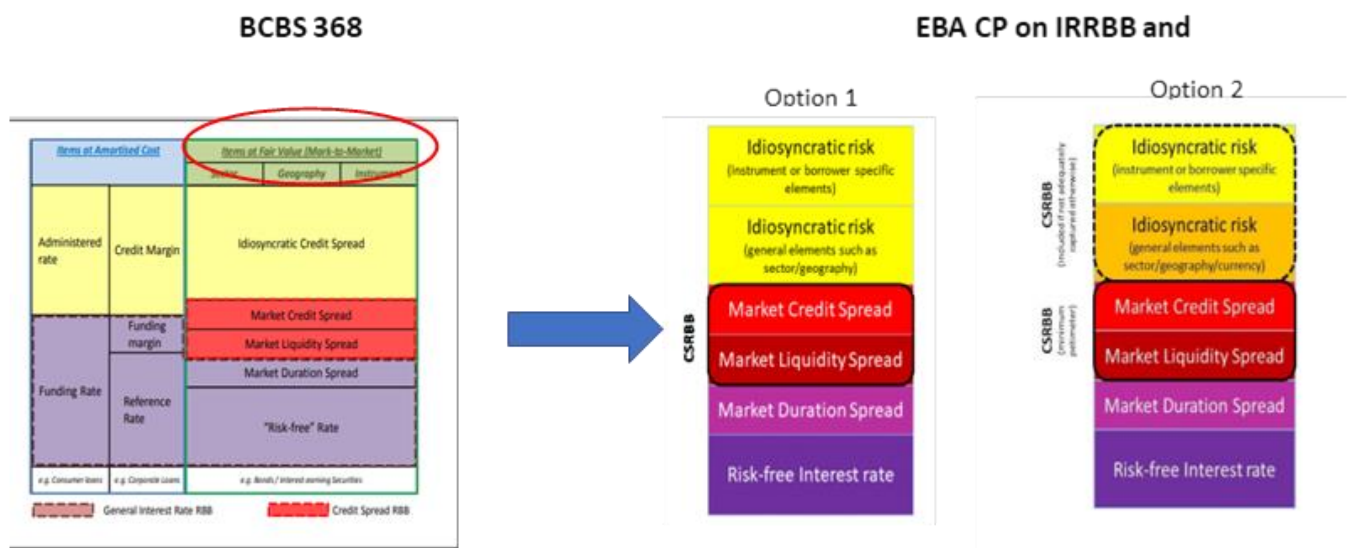
a. The definition implies that a market credit spread and market liquidity spread component can be identified for corporate and consumer loans
b. The definition implies that a market credit spread and market liquidity spread component can be identified for the funding products. Could you provide an example?
c. If so, would it be possible to provide:
    i. an example on how these would be determined for a 20y fixed rate mortgages?
    ii. An example on how the market credit spread and market liquidity spread component for own issued bonds should be determined?
d. Would it be possible to explain how NII (and SOT NII) is impacted in case of changes in CSRBB of items against amortized costs?

The scope includes the liability side of the balance sheet but the GL does not provide guidance on potential netting from similar instruments on both sides of the balance sheet. Further, the consultation states that a deterioration of an institution's credit quality should not have any positive impact on the credit spread risk measure. Notwithstanding idiosyncratic risk, some clarification is needed on whether a deterioration in own credit due to changes in general market credit spreads is in scope.

Even if the EBA insists on expanding the perimeter of Credit Spread Risk to all financial instruments outside the trading book, we noted that the EBA by means of article 14 has expanded the scope of article 84.6c for CSRBB, where institutions are only obliged to assess and monitor credit spread risk. Article 14 of this GL now also obliges institutions to control credit spread risk. However in article 84 the CRD explicitly differentiates between IRRBB and CSRBB, where the management and mitigation is limited to IRRBB. Asking institutions to control credit spread is beyond the mandate of the EBA and not deemed proportionate. A similar observation is done for articles 126 and 127, where this GL states that CSRBB should be part of the risk appetite of an institution. Not only is this beyond the mandate provided to the EBA based on article 84.6c, but institutions already factor in the effect of fluctuating credit spreads as part of business risk and liquidity risk. Therefore this also results in double counting.

Question 4: As to the suggested perimeter of items exposed to CSRBB, would you consider any specific conceptual or operational challenge to implement it?

Before answering this question, we would like to highlight that we do not agree with the scope of the items, which are exposed to CSRBB. EBA has widened the scope for the measurement and monitoring of CSRBB that includes not only fair value instruments but also other instruments that are not fair valued and are not part of existing EBF's common understanding of CSRBB. The scope states that no instruments in the banking book should be excluded from the scope of CSRBB (e.g. off balance sheet loan commitments), however by definition the scope is limited to those instruments with exposure to market credit and market liquidity spread risk and observable credit spread activity. The definition of the perimeter should therefore be explicitly reduced to state this. Further, the GL does not provide clear guidance on the instruments to be included for CSRBB measurement. We refer to the original definition of CSRBB in the BCBS paper:



Considering this definition and the scope of application in detail, it is clear that CSRBB targets the risk driven by changes of the market price for credit risk, for liquidity and for potentially other characteristics of credit-risky instruments, which is not captured by IRRBB or by expected credit/(jump-to-) default risk. Hence, CSRBB relates to market tradable assets of the Banking Book.
Indeed, from the initial part of the definition, only instruments that have a clear market price transparency are considered, i.e. easily tradable on a large and deep enough market, since only such market tradable assets are subject to such a market perception.

Response:

Yes, implementation is operationally challenging as:

a. The specific components market credit spread and market liquidity spread as referred to in art. 120 cannot be captured for items on amortized cost by our systems. This requires an operational challenge to develop and implement this.
b. Development of systems, standards, procedures for updating shocks/parameters/scenarios, reporting and review process, internal control and management information systems as mentioned under article 131.
c. Not possible to comply with article 140, 141, 150, 152 and 153.

Furthermore we have the following remarks on specific articles:

- *121. CSRBB does not include the effect of credit quality changes during the observation period (i.e. rating category downgrade/upgrade of a specific counterparty or instrument, considered as migration risk). In particular, the deterioration of an institution's credit quality should not have any positive impact on the credit spread risk measure.*

What is meant with observation period? Is this the same as the forecast period?
What does this mean for own issued debt?

- *122. CSRBB excludes instruments under default situation.*

Non-performing exposures are considered for IRRBB (art.84) but how about CSRBB?

- *123. When assessing changes in credit risk premium and liquidity premium movements, institutions can consider currency specific dimensions (i.e. EUR, USD, etc.) as a relevant dimension for market credit spread and market liquidity spread.*

Is this optional? What relevant dimensions for market credit spread and market liquidity spread should be considered?

- *124. Institutions should not exclude any instrument in the banking book from the perimeter of CSRBB ex ante, including assets, liabilities, derivatives and other off-balance sheet items such as loan commitments, irrespective of their accounting treatment. Any potential exclusion of instruments from the relevant perimeter should be done in the case of the absence of sensitivity to credit spread risk and should be appropriately documented and justified. In any case, institutions should not exclude assets accounted at fair value.*

What is considered appropriately documented and justified? Can you prescribe this more explicitly?
Does the last sentence imply that in order to comply banks should report for CSRBB at minimum assets at fair value?

- *127. The institution's risk appetite for CSRBB should be expressed in terms of the impact of fluctuating credit spreads on both net interest income and economic value. Institutions significantly exposed to CSRBB should reflect this appropriately within their risk appetite.*

How does CSRBB impacts NII other than for new business? Especially impact of CSRBB items at amortized costs should be excluded of the scope or this GL should reflect the option described on p 63-64.
Is the interpretation correct that this implies that CSRBB framework should be developed as a standalone risk-appetite framework?

- *130 (b) That they have in place a CSRBB management framework that establishes clear lines of responsibilities and that consists of policies, processes and internal controls including regular independent reviews and evaluations of the effectiveness of the framework.*

Should this be a separate management framework or integrated in IRRBB?

- *130 (c) Approving major CSRBB risk-taking initiatives in advance of implementation. Positions related to internal risk transfers between the non-trading book and the trading book should be properly documented.*

It is unclear what is meant with major CSRBB risk-taking initiative.

- *131. The management body* ***or an appropriate committee, such as the ALCO,*** *should, in particular, be responsible for the following:*

(b) Establishing that the appropriate actions are taken to assess and monitor CSRBB, consistent with the approved strategies and policies. In this regard, the management body or its delegates are responsible for setting:

i. *Systems and standards for monitoring CSRBB, valuing positions and assessing performance, including procedures for updating shock, parameters and stress scenarios and key underlying assumptions driving the institution's CSRBB analysis;*
ii. *A comprehensive CSRBB reporting and review process; and*
iii. *Effective internal controls and management information systems (MISs).*

In our view the management body could delegate this to an appropriate committee, such as the ALCO.

- *139 (e) Enable the institutions to fully measure, assess and monitor the contribution of individual transactions to their overall exposure.*

This would be impossible for retail products and seems only applicable to an investment portfolio?

- *159. Institutions should, in relation to both economic value and net interest income based measures of CSRBB, take into account the implications of accounting practices for the measurement of CSRBB, and in particular hedge-accounting effectiveness.*

Can you explain this in more detail, with an example?

- *160. If the reliability and stability of diversification assumptions are appropriately validated and documented; diversification between CSRBB and IRRBB may be possible. Under the same condition, diversification assumptions between CSRBB and other risks may be possible. The diversification effects should be estimated conservatively enough to be assumed to be sufficiently stable even in economic downturns and under market conditions that are unfavourable for the institution's business and risk structure. In any case institutions should have separate assessments of CSRBB and IRRBB.*

ARE CSRBB and IRRBB standalone measures (and risk-appetite) or combined? In the article above it is stated that diversification can be applied. Does this imply a more integrated approach?

Question 5: Is the separation of IRRBB and CRSBB sufficiently to understand where the guidelines apply to:

- **IRRBB only**
- **CSRBB only**
- **Both IRRBB and CRSBB?**

Response:

We repeat our remark on the differentiating made in article 94.6 of CRD5, where the EBA shall issue GL to identify, manage and mitigate IRRBB and only to assess and monitor CSRBB. Articles 126 and 127 are clearly outside the mandate of the EBA as this refers to managing and mitigating CSRBB.

However, apart from non-performing exposures and our remark above, the separation of IRRBB and CRSBB is clear to us.

Other remarks (apart from the 4 specific questions):

- p32, paragraph 67, second sentence: suggest changing into "Institutions should assess the modelled prepayment rates against historical rates", i.e., replacing losses by rates. Prepayment rates are more readily observable, prepayment losses is a bit of an ambiguous term and not sure if all institution would forecast prepayment losses.

- P37, paragraph 93 – e: typo: are -> is and ".;" at the end of the line

- P39, articles 102 and 103: Could you provide examples of what is exactly expected per these articles?

- P55, EVE metric :

  > *"PV01 of equity is obtained by multiplying the modified duration of equity by the value of equity (i.e. assets minus liabilities) and dividing by 10 000 to arrive at the value change per basis point."*

  This seems a bit of a strange definition. We would expect PV01 to be a stand-alone metric obtained by shocking the yield curve by 1bps and not a derived metric from the modified duration using 100bps.

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