

**European Banking Authority (EBA) Consultation Paper (CP) on the  
Supervisory Shock Scenarios, Common Modelling and Parametric Assumptions and What Constitutes a  
Large Decline for the Calculation of the Economic Value of Equity and of the Net Interest Income**  
Published 2 December 2021 with Consultation End 4 April 2022

Link to Consultation Paper: [CP Draft RTS on SOTs.pdf \(europa.eu\)](#)

## **Glossary**

<i>BB:</i>	Banking Book (i.e. non-Trading Book)
<i>BCBS:</i>	Basel Committee on Banking Supervision
<i>bp:</i>	basis point (0.01%)
<i>CET1:</i>	Common Equity Tier One
<i>CP:</i>	Consultation Paper
<i>CRD:</i>	Capital Requirement Directive
<i>CRR:</i>	Capital Requirement Regulation
<i>CSRBB:</i>	Credit Spread Risk in the Banking Book
<i>EBA:</i>	European Banking Authority
<i>EV:</i>	Economic Value
<i>EVE:</i>	Economic Value of Equity
<i>EBF:</i>	European Banking Federation
<i>FBF:</i>	French Banking Federation
<i>IMS:</i>	Internal Management System
<i>IRRBB:</i>	Interest Rate Risk in the Banking Book
<i>NII:</i>	Net Interest Income
<i>NMD:</i>	Non-Maturing Deposit
<i>OCI:</i>	Other Comprehensive Income
<i>RTS:</i>	Regulatory Technical Standard
<i>SOT:</i>	Supervisory Outlier Test
<i>Standard:</i>	Standards on Interest Rate Risk in the Banking Book published by BCBS in April 2016

## **Executive Summary:**

**The French Banking Federation (FBF)** welcomes the opportunity to express the views of the French banking industry on the public consultation on the Supervisory Shock Scenarios, common modelling and parametric assumptions and what constitutes a large decline for the calculation of the Economic Value of Equity and of the Net Interest Income. In this context, we herewith provide you with our general remarks and responses to the questions listed in the Consultation Paper (CP). We appreciate your consideration about our comments and remain at your disposal for further clarifications.

Article 98(6) of Capital Requirement Directive (*CRD*) tasks the European Banking Authority (*EBA*) with developing a Regulatory Technical Standard (*RTS*) to define:

- supervisory shock scenarios: six for Supervisory Outlier Test (*SOT*) on *Economic Value of Equity (EVE)*, and two (i.e. that are not necessarily from the previous six) for *SOT on Net Interest Income (NII)*;
- common modelling and parametric assumptions, excluding behavioural assumptions (e.g. *NMD's*) for *SOT EVE* and *SOT NII* which shall be limited to own equity, inclusion, composition and discounting of cash flows [...] including the treatment of commercial margins and other spread components;
- the large decline threshold for *SOT NII*.

Please find below our comments on the Consultation Paper (*CP*) on draft *RTS*:

- **the *CP* envisages to change the definition of commonly understood Net Interest Income (NII) to include changes in fair values of instruments** even though they are not part of *NII*. This appears as a deviation from the *CRR* mandate that explicitly refers to *NII*. It also deviates from *BCBS Standards* that is quite explicit that it refers to *NII* excluding changes in fair values that don't affect *NII*. This would also be at odds with actual risk management and would introduce overlapping between *NII* measures and *Economic Value (EV)* measures while they should be complementary. ***NII* should be kept as defined by interest income and expenses.**
- To be aligned with the mandate, **the draft *RTS* should explicitly mention that the common modelling and parametric assumptions should exclude behavioral assumptions and should apply only to the calculation of *SOT's*.** The behavioral assumptions should align with internal management system (*IMS*) behavioral assumptions without limitations (e.g. no caps on *NMD's*) so that the interest rate risk is adequately measured. It is essential to avoid uneconomic interest rate risk measurement and management that would be driven to satisfy one or the two *SOT*.
- the *CP* envisages to apply two supervisory parallel shock scenarios for *SOT NII* that apply instantaneously with magnitudes that are not consistent with facts. In developed countries, Central Banks carefully modify their interest rates over time with managing market expectations to avoid triggering market surprises. Hence, their expected changes are factored in the interest rate curve well *before* the changes actually occur. As shocks apply *on top of* those expected changes, the shocks should be adapted.

To better fit reality, it would make better sense to assume that the shocks are applied *gradually* over the considered 12 months horizon. Conscious of the operational complexities that banks may be confronted with such a gradual scenario, **we recommend a more pragmatic solution by adopting a lower magnitude for the elected instantaneous shock.**

**The magnitude of the two *SOT NII* supervisory parallel shock scenarios should be made more consistent with facts and its immediate application: a  $\pm 100$  basis points (*bps*) for most developed currencies (e.g. *EUR*, *USD*) would be more relevant** (vs. the envisaged  $\pm 200$  *bps*).

- The *CP* that *SOT NII* is suggested to be calculated with a constant balance sheet.  
**It should be clarified that within this constant balance sheet requirement, Internal Management System (*IMS*) assumptions, such as behavioural assumptions, apply.**  
To the extent that a dynamic balance approach would be used in *IMS*, notably when the dynamic balance sheet enables to capture behavioural assumptions that excluded from the scope of common parametric assumptions, we believe that **a discretion should be provided for the bank and the competent authority to use dynamic balance sheet for *SOT NII*.** As public disclosures requirements are based on *SOT NII* assumptions (which is a deviation from *BCBS Standard*), such a discretion would enable consistency with actual management.

- For the definition of large decline threshold for *SOT NII*:
  - Option B appears to benefit from a denominator that is in direct relation with the numerator. However, the introduction of non-*NII* related components make it complex and variable for no *NII*-reasons.
  - Option A appears as simpler and less prone to variability and pro-cyclicality, though Tier One does not directly relate to *NII* generation.
  - **The *FBF* favors Option A since it is less prone to variability over time.**
  - Whichever option is finally determined, we notice that a large decline in itself is no reason to impose supervisory measures. It is very well possible that even if a bank encounters a large decline the resulting *NII* is still largely positive (in particular if interest rate levels return to normalized levels). Furthermore banks factor in this risk as part of business risk under Pillar 2. Imposing supervisory measures thus may lead to double counting.
  - The value of large decline should not be defined yet as it requires further analyses to make sure it is relevant and consistent through time (i.e. not point in time), across scope of application (i.e. individual and consolidated level). We have strong concerns on the methodology that is envisaged by *EBA* to set this large decline threshold as it is not risk based.
 

**Further analyses should be developed over time before electing a specific ratio and its accompanying large decline thresholds.**
- As regards the proposed recalibration of the lower bound, to be applied to post-shock interest rate levels, we do not see the need for such change. For the *SOT* on *NII* this lower bound is mainly determined by policies of the central banks. Nowadays this is large consensus that setting a policy rate below – 100 *bps* is ineffective. Therefore, the recalibrated lower bound seems rather unrealistic. Thus, **we do not support the proposed change in the lower bound. Should nonetheless the lower bound be changed, this should be factored in the calibration of the threshold.**
- The *CP* should clarify that as *EVE* and *NII* sensitivities cannot be simultaneously reduced, the analysis of *SOT EVE* and *SOT NII* needs to be done in combination by competent authority.

**The *CP* should clarify that the *SOTs* serve as an indication for competent authorities only, as explicitly stated in article 98.5 of the CRD5. In that sense**

- **no automatic supervisory measures should apply in case of crossing *SOT's* thresholds. There should be no direct link between the *SOT's* and the identification of internal capital that may be identified for *IRRBB*.**
- **no full integration of *SOTs* into the internal measurement and/ or management should be required.**
- **no (Pillar 3) disclosure obligation should be applied.**
- We would like to stress that the implementation of the *Guideline* will require a significant time to be carried out. Consequently, a sufficient period (at least 1 year) should be assigned before application. Ideally, the final application date of the *Guideline* should be aligned with the application of the technical standards, as the *EBA* suggested already in article 8.

**Additional recommended changes and comments are detailed below.**

We are committed to elaborate a sound and robust management framework for *IRRBB* and *CSRBB* and remain available to *EBA* to support its efforts.

## **EBA CP Questions:**

This section addresses the questions listed in the *EBA CP*.

**Question 1:** *Do respondents find the common modelling and parametric assumptions for the purpose of the EVE SOT and the NII SOT in Articles 4 and 5 clear enough and operationally manageable? Specifically, the EBA is seeking comments on the recalibrated lower bound for post-shock IR levels in the EVE SOT and NII SOT as well as on the use of a one-year time horizon and a constant balance sheet with current commercial margins for new business for the NII SOT. Respondents are also kindly requested to express whether they find an inclusion of market value changes in the calculation of the NII SOT clear enough.*

- **the CP envisages to change the definition of commonly understood Net Interest Income (NII) to include changes in fair values of instruments** even though they are not part of *NII*. This appears as a deviation from the *CRR* mandate that explicitly refers to *NII*. It also deviates from *BCBS Standards* that is quite explicit that it refers to *NII* excluding changes in fair values that don't affect *NII*. This would also be at odds with actual risk management and would introduce overlapping between *NII* measures and Economic Value (EV) measures while they should be complementary. ***NII* should be kept as defined by interest income and expenses.**
- the *CP* envisages to apply two supervisory parallel shock scenarios for *SOT NII* that apply instantaneously with magnitudes that are not consistent with facts. In developed countries, Central Banks carefully modify their interest rates over time with managing market expectations to avoid triggering market surprises. Hence, their expected changes are factored in the interest rate curve well *before* the changes actually occur. As shocks apply *on top of* those expected changes, the shocks should be adapted.

To better fit reality, it would make better sense to assume that the shocks are applied *gradually* over the considered 12 months horizon. Conscious of the operational complexities that banks may be confronted with such a gradual scenario, **we recommend a more pragmatic solution by adopting a lower magnitude for the elected instantaneous shock.**

**The magnitude of the two *SOT NII* supervisory parallel shock scenarios should be made more consistent with facts and its immediate application: a  $\pm 100$  basis points (*bps*) for most developed currencies (e.g. EUR, USD) would be more relevant** (vs. the envisaged  $\pm 200$  *bps*).

- The *CP* that *SOT NII* is suggested to be calculated with a constant balance sheet.  
**It should be clarified that within this constant balance sheet requirement, Internal Management System (IMS) assumptions, such as behavioural assumptions, apply.**  
To the extent that a dynamic balance approach would be used in *IMS*, notably when the dynamic balance sheet enables to capture behavioural assumptions that excluded from the scope of common parametric assumptions, we believe that **a discretion should be provided for the bank and the competent authority to use dynamic balance sheet for *SOT NII***. As public disclosures requirements are based on *SOT NII* assumptions (which is a deviation from *BCBS Standard*), such a discretion would enable consistency with actual management.

- For the definition of large decline threshold for *SOT NII*:
  - Option B appears to benefit from a denominator that is in direct relation with the numerator. However, the introduction of non-*NII* related components make it complex and variable for no *NII*-reasons.
  - Option A appears as simpler and less prone to variability and pro-cyclical, though Tier One does not directly relate to *NII* generation.
  - **The *FBF* favors Option A since it is less prone to variability over time.**
  - Whichever option is finally determined, we notice that a large decline in itself is no reason to impose supervisory measures. It is very well possible that even if a bank encounters a large decline the resulting *NII* is still largely positive (in particular if interest rate levels return to normalized levels). Furthermore banks factor in this risk as part of business risk under Pillar 2. Imposing supervisory measures thus may lead to double counting.
  - The value of large decline should not be defined yet as it requires further analyses to make sure it is relevant and consistent through time (i.e. not point in time), across scope of application (i.e. individual and consolidated level). We have strong concerns on the methodology that is envisaged by *EBA* to set this large decline threshold as it is not risk based.
 

**Further analyses should be developed over time before electing a specific ratio and its accompanying large decline thresholds.**
- As regards the proposed recalibration of the lower bound, to be applied to post-shock interest rate levels, we do not see the need for such change. For the *SOT* on *NII* this lower bound is mainly determined by policies of the central banks. Nowadays this is large consensus that setting a policy rate below -/- 100 bps is ineffective. Therefore, the recalibrated lower bound seems rather unrealistic. Thus, **we do not support the proposed change in the lower bound. Should nonetheless the lower bound be changed, this should be factored in the calibration of the threshold.**
- The *CP* should clarify that as *EVE* and *NII* sensitivities cannot be simultaneously reduced, the analysis of *SOT EVE* and *SOT NII* needs to be done in combination by competent authority.

**The *CP* should clarify that the *SOTs* serve as an indication for competent authorities only, as explicitly stated in article 98.5 of the CRD5. In that sense**

- **no automatic supervisory measures should apply in case of crossing *SOT's* thresholds. There should be no direct link between the *SOT's* and the identification of internal capital that may be identified for *IRRBB*.**
- **no full integration of *SOTs* into the internal measurement and/ or management should be required.**
- **no (Pillar 3) disclosure obligation should be applied.**

***Make Explicit that Behavioural Assumptions are Excluded from Common Parametric Assumptions for the *SOT's*:***

To ensure consistency with the *CRD* mandate, it should be clarified that *common modelling and parametric assumptions* exclude *behavioural assumptions*:

*Recital (2) For the purposes of the calculations of the cited economic value of equity and net interest income **calculations for Supervisory Outlier Test (SOT)**, this Regulation seeks to specify common modelling and parametric assumptions, **at the exclusion of behavioral assumption**, that institutions should use. To that end, it is appropriate to set out in this Regulation that for the calculation of the*

*net interest income, a constant balance sheet assumption over a one-year time horizon should be used while, for the calculation of the economic value of equity, a run-off balance sheet assumption should be used where maturing positions are not replaced. These assumptions aim to provide a good balance in terms of calculation accuracy, reliability of estimates and operational complexity.*

For sake of consistency and adherence to actual risk management, we recommend that the discretion to include commercial margins (i.e. all spreads beyond the risk free interest rate component) that applies to the *EVE SOT* is applied also to *NII SOT*. This is all the more consistent as those spreads are envisaged as locked to their recent values and as *NII SOT* is based on a *NII* sensitivity which makes the inclusion of the spread irrelevant.

We recommend the changes below to be made

*Recital (3) To strike the right balance between ensuring comparability of the results and providing the flexibility necessary due to the long term horizon and the inherent operational complexity, this Regulation should set out that commercial margins and spread components ~~should be included in the calculation of the net interest income, but for the calculation of the economic value of equity,~~ institutions should proceed in accordance with their internal management and measurement approach for interest rate risk in the non-trading book **for the calculation of the economic value of equity and net interest income.***

### **Interest Rate Shocks:**

The magnitudes and forms of the shocks that apply to both *SOT*'s are inconsistent with historical rates. As a consequence, they are also inconsistent and far more severe than the typical shocks that are applied to interest rate risk in the trading book. As the threshold on *EVE SOT* is set by regulation at 15%, the underlying interest rate scenarios should be considered carefully.

In developed economies such as Europe and the U.S. for instance, Central Banks manage short term rates and factor more and more the impacts on long terms in their decision-making process. In those economics, the assumption of a  $\pm 200$  bps immediate shocks on short term rates are completely unrealistic. Such shocks would necessarily take time to materialize.

The fundamental differences between *EVE* that is an instantaneous economic value metric '*as seen from the calculation date*' and *NII* that covers a '*going through period*' should be considered. By its very definition, *EVE* requires a shock applied to the *as of date curve*, i.e. instantaneous shock. Conversely, *NII* requires to specify the curve as it will evolve over the considered period.

Should the very same parallel scenario shocks apply to *EVE SOT* and *NII SOT*, it should be specified that, when applied to *NII SOT*, they should be applied gradually over the considered period with linear interpolation between the as of date and the end of considered period. Alternatively, lower shocks should be applied for *NII SOT* as it does not make sense to assume that all interest rates are changed by  $\pm 200$  basis points immediately.

**We recommend that:**

- **the interest rate shocks that apply to *NII* are applied linearly over the considered period** (i.e. the  $\pm[xx]$  bps shock would apply at the end of the [one year] period with linear interpolation between);  
or
- **the magnitudes of the shocks that apply to *NII* are reduced by [half] to be consistent with facts.**

Consequently, the paragraph 2 should be modified from:

*2. The two supervisory shock scenarios referred to in Article 98 (5), point (b) of Directive 2013/36/EU shall be the following:*

*(a) parallel shock up, where there is a parallel upwards shift of the yield curve with the same positive interest rate shocks for all maturities; and*

*(b) parallel shock down, where there is a parallel downwards shift of the yield curve with the same negative interest rate shocks for all maturities.*

To either:

*2. The two supervisory shock scenarios referred to in Article 98 (5), point (b) of Directive 2013/36/EU shall be the following:*

*(a) parallel shock up, where there is a parallel upwards shift of the yield curve with the same positive interest rate shocks for all maturities **applied gradually with a linear gradation over 12 months**; and*

*(b) parallel shock down, where there is a parallel downwards shift of the yield curve with the same negative interest rate shocks for all maturities **applied gradually with a linear gradation over 12 months**.*

or:

*2. The two supervisory shock scenarios referred to in Article 98 (5), point (b) of Directive 2013/36/EU shall be the following:*

*(a) **half the magnitude of the** parallel shock up, where there is a parallel upwards shift of the yield curve with the same positive interest rate shocks for all maturities; and*

*(b) **half the magnitude of the** parallel shock down, where there is a parallel downwards shift of the yield curve with the same negative interest rate shocks for all maturities.*

### **Comments specifics to EVE SOT:**

#### **As for Article 4(k) on floors:**

*Article 4 (k) A maturity-dependent post-shock interest rate floor shall be applied for each currency starting with -150 basis points for immediate maturity. This floor shall increase by 3 basis points per year, eventually reaching 0% for maturities of 50 years and more. If observed interest rates are lower than the post-shock interest rate floor, institutions shall apply the lower observed interest rate.*

We understand the rationale for changing the floor whose accuracy has not been demonstrated. However, we question the process of calibration of this floor for both following aspects:

- The retained value – is there any evidence that such a floor will be observed in the future?
- The value of the associated SOT threshold which should be re-assessed in the context of this new floor

From our point of view, the calibration of the SOT threshold is all the more required that Article 98.5 is now in force since June 2021, that it empowers the supervisor based on a threshold (15% of CET1) that was to our knowledge assessed only at group consolidated level only by BCBS. Other modifications that are

envisaged through the CP on management framework that would limit behavioural assumptions (e.g. caps on NMD's) of the current SOT should be assessed:

- In CP 2021/38, it is defined in Article 1 of CP 2021/38 as the definition given in Article 411 (1) of Regulation (EU) 575/2013.
- In EBA GL 2018/02 (p111), the definition refers to point (26) of Article 4(1) of Regulation (EU) No 575/2013

As for Article 4(i):

*(i) When calculating the aggregate change for each interest rate shock scenario, institutions shall add together any negative and positive changes occurring in each currency. Positive changes shall be weighted by a factor of 50% or a factor of 80% in the case of Exchange Rate Mechanism - ERM II currencies with a formally agreed fluctuation band narrower than the standard band of +/- 15% to offset losses in EUR. However, if the absolute value of 80% of the ERM II currency gains is larger than the absolute value of the EUR loss then a factor of 50% shall apply to positive changes in ERM II currencies.*

We understand from Article 4 (i) that a new aggregation rule is proposed by EBA for EVE SOT and NII SOT computation.

### **Specific Treatment of ERM-Currencies:**

Our understanding is that for ERM – II currencies (namely currently BGN, DKK, HRK), EVE sensitivity may offset only EUR losses and not gains of the EVE sensitivity in EUR and only to the extent that the overall sum remains negative.

Our understanding is that if we note  $\Delta\text{EVE}(\text{CUR})$  the EVE sensitivity of a currency CUR, then for all CUR in the balance sheet, one should define a coefficient  $\alpha_{\text{CUR}}$ , as follows:

- $\alpha_{\text{CUR}} = 100\%$  if  $\Delta\text{EVE}(\text{CUR}) < 0$  for all currencies
- $\alpha_{\text{CUR}} = 50\%$  if  $\Delta\text{EVE}(\text{CUR}) > 0$  and CUR is not a currency belonging to EMR – II
- $\alpha_{\text{CUR}} = 80\%$  if  $\Delta\text{EVE}(\text{CUR}) > 0$  and CUR is a EMR-II currency and  $80\% \times \Delta\text{EVE}(\text{CUR}) + \Delta\text{EVE}(\text{EUR}) < 0$
- $\alpha_{\text{CUR}} = 50\%$  in all other cases (namely if  $\Delta\text{EVE}(\text{CUR}) > 0$  and CUR is a EMR-II currency and  $80\% \times \Delta\text{EVE}(\text{CUR}) + \Delta\text{EVE}(\text{EUR}) \geq 0$ )

If yes, we believe:

- i) The above formula should be given to support the text which is subject to interpretation
- ii) In particular, we understand in the above formula that it should be applied Currency by Currency (therefore the following situation may occur where for example  $\alpha_{\text{CUR}} = 80\%$  for all CUR= DKK, BGN and KRN and  $80\% \times [\Delta\text{EVE}(\text{BGN}) + \Delta\text{EVE}(\text{DKK}) + \Delta\text{EVE}(\text{KRN})] + \Delta\text{EVE}(\text{EUR}) > 0$ )
- iii) The formula is not continuous which may look a bit odd  
For example, if a balance sheet has positions only in EUR and DKK and  $\Delta\text{EVE}(\text{EUR}) = -80$  then one would have:
  - $\Delta\text{EVE} = -30$  if  $\Delta\text{EVE}(\text{DKK}) = 100$  then one would
  - $\Delta\text{EVE} = -0,8$  if  $\Delta\text{EVE}(\text{DKK}) = 99$  then one would



### **Clarification:**

The Supervisory Outlier Test should focus on risk-free interest rate. We recommend the suppression of the paragraph below:

~~Article 4 (n) In assessing the risk of interest rate-sensitive products that are linked to inflation or other market factors, prudent assumptions shall be applied. These assumptions shall be based on the current/last observed value, on forecasts of a reputable economic research institute or on other generally accepted market practices and shall be generally scenario independent.~~

Inflation is different than interest rate risk as there could be changes in interest rates that are unrelated to changes in inflation. As the SOT's aim at measuring interest rate risk, we believe that inflation should be kept constant in those measurements. To the extent that a bank would identify material inflation exposures, it should factor it in its risk management framework.

**Question 2: Do respondents have any comment related to these two metrics for the specification and the calibration of the test statistic for the large decline in Article 6 for the purpose of NII SOT? Specifically, do respondents find the inclusion of administrative expenses in metric 2 clear enough? Do respondents have any comment on the example on currency aggregation for metric 1 and metric 2?**

### **Net Interest Income should be... Net Interest Income as it is commonly understood**

- **The CP envisages to change the definition of commonly understood Net Interest Income (NII) to include changes in fair values of instruments even though they are not part of NII.** This appears as a deviation from the CRR mandate that explicitly refers to NII. It also deviates from BCBS Standards that is quite explicit that it refers to NII excluding changes in fair values that don't affect NII. This would also be at odds with actual risk management and would introduce overlapping between NII measures and Economic Value (EV) measures while they should be complementary. **NII should be kept as defined by interest income and expenses.**

Net Interest Income (NII) means net interest income that is widely defined as the portion that impact the profit and loss statement.

Considering the changes in Other Comprehensive Income (OCI) and/or in capital as NII would be inconsistent with commonly accepted definition of NII, with CRD and with BCBS.

It would be so flawed as it would disincentivize to hedge with cash flow hedging instruments as their changes in fair value would be considered as a risk to NII while they are entered into precisely to make NII less sensitive.

**We urge EBA to adhere to the common definition of NII, not to invent another definition of its own and to be consistent to the mandate provided by CRD that refers to Net Interest Income. EBA would deviate from its mandate by extending the definition of NII.**

**It is reminded that the economic value perspective has also to be considered and that the extension of NII measures would create overlap with EV measures.**

Several paragraphs need to be fixed of this deviation:

~~15. For the purposes of these Guidelines, the net interest income upon which to calculate the impact of interest rate or credit spread movements should be determined by the interest income and expenses, and the market value changes of instruments — depending on accounting treatment — either shown in the profit and loss account or directly in equity (e.g. via other comprehensive income). Institutions should take into account the increase or reduction in the amount of profit and~~

~~losses and capital~~ over short- and medium-term horizons resulting from interest rate or credit spread movements.

~~§27(e) the impact on economic value and net interest income (including effects on the fair value through other comprehensive income (FVOCI) portfolio) of mismatched positions in different currencies;~~

~~§31(d) The relative importance of interest rate sensitive instruments (including interest rate derivatives) in the non-trading book, with potential effects shown either in the profit and loss account or directly in equity (e.g. via other comprehensive income);~~

~~§44(c) In defining their risk appetites, institutions should take account of net interest income risks that may arise as a consequence of the accounting treatment of transactions in the non-trading book. The risk to net interest income may not be limited to interest income and expenses: the effects of changes in interest rates on the market value of instruments that, depending on accounting treatment, are reflected either through the profit and loss account or directly in equity (via other comprehensive income), should be taken into account separately. Institutions should particularly take into account the impact related to embedded optionalities in fair value instruments under ongoing interest rate shocks and stress scenarios. Institutions should also take into account the potential impact on the P&L accounts of hedging interest rate derivatives if their effectiveness was hampered by interest rate changes.~~

Some extracts from *BCBS Standard* relating to earnings are worth reminding as they clearly highlight that earnings are considered as *NII*:

*§8. IRRBB refers to the current or prospective risk to the bank's capital and earnings arising from adverse movements in interest rates that affect the bank's banking book positions. When interest rates change, the present value and timing of future cash flows change. This in turn changes the underlying value of a bank's assets, liabilities and off-balance sheet items and hence its economic value. Changes in interest rates also affect a bank's **earnings by altering interest rate-sensitive income and expenses, affecting its net interest income (NII)**. Excessive IRRBB can pose a significant threat to a bank's current capital base and/or future earnings if not managed appropriately.*

*§69. The level of IRRBB exposure should be measured and disclosed. Specifically, banks must disclose the measured  $\Delta$ EVE and  $\Delta$ NII under the prescribed interest rate shock scenarios set out in Annex 2.*

*§93. A bank could also be considered to have excessive risk relative to **earnings if its shocked  $\Delta$ NII** was such that the bank would not have sufficient income to maintain its normal business operations.*

Article 5 (b) as well as a portion of Article 6(2) should be deleted:

~~Art.5.(b) For non-trading book financial instruments accounted at fair value with a maturity of more than one year, the annual change in their market value shall be considered. [this point b) will be kept if the option to add market value changes is finally decided by the EBA]~~

~~Art.6(2) [...] NIIhist is the latest year-end historical NII from FINREP, calculated for these purposes as the difference between the amount of "Interest income" and "Interest expenses", as reported in column 0010 of rows 0010 and 0090 respectively of the template F02.00 on the "Statement of profit or loss". [If market value changes are decided to be included by the EBA in the net interest income under Article 5 the following alternative drafting will be included: "NII is the latest year-end historical NII from FINREP, calculated for these purposes as the difference between the amount of "Interest income" and "Interest expenses", as reported in column 0010 of rows 0010 and 0090,~~

*plus "Gains or (-) losses on non trading financial assets mandatorily at fair value through profit or loss, net" and "Gains or (-) losses on financial assets and liabilities designated at fair value through profit or loss, net", as reported in column 0010 of rows 0287 and 0290, of the template F02.00 on the "Statement of profit or loss".]*

### **Scope and Dynamic of the Balance Sheet to Calculate NII:**

NII should be calculated covering the entire BB without excluding portion of it. As an illustration, CET1 contributes to the NII through their reinvestment in interest bearing assets. That is the reason why Article 4(i) does not apply to NII.

The discretion to include or not commercial margins should apply to both EVE SOT and NII SOT and be aligned internal management system: Article 4(i) applies to NII SOT as well.

Article 5 (c) and Article 5(d) should be modified:

*(c) The assumptions established in Article 4, except its points (c) (i) and (j), of this Regulation, shall apply here.*

*~~(d) Institutions shall include commercial margins and other spread components.~~*

The dynamic of the balance sheet should be consistent with internal models for actual risk management. It is reminded that all discrepancies between NII SOT and internal models will lead to inconsistent public disclosures as NII SOT is publicly disclosed as well as other NII sensitivities reported by the institution.

Article 5 (e) should be modified:

*(e) Institutions shall compute the change in the net interest income **using their internal models for the dynamic of the** ~~under the assumption of a constant balance sheet, where its total size and composition, including on and off balance sheet items, shall be maintained by replacing maturing or repricing cash flows with new instruments that have comparable features with regard to the currency, amount and repricing period of the instruments generating the repricing cash flows. Margins of the new instruments shall be based on the margins from recently bought or sold products with similar characteristics. In the case of instruments with observable market prices recent market spreads shall be used and not historical market spreads.~~*

### ***Definition of Ratios and Large Decline Threshold:***

- For the definition of large decline threshold for *SOT NII*:
  - Option B appears to benefit from a denominator that is in direct relation with the numerator. However, the introduction of non-*NII* related components make it complex and variable for no *NII*-reasons.
  - Option A appears as simpler and less prone to variability and pro-cyclicality, though Tier One does not directly relate to *NII* generation.
  - **The *FBF* favors Option A since it is less prone to variability over time.**
  - Whichever option is finally determined, we notice that a large decline in itself is no reason to impose supervisory measures. It is very well possible that even if a bank encounters a large decline the resulting *NII* is still largely positive (in particular if interest rate levels return to normalized levels). Furthermore, banks factor in this risk as part of business risk under Pillar 2. Imposing supervisory measures thus may lead to double counting.
  - The value of large decline should not be defined yet as it requires further analyses to make sure it is relevant and consistent through time (i.e. not point in time), across scope of application (i.e. individual and consolidated level). We have strong concerns on the methodology that is envisaged by *EBA* to set this large decline threshold as it is not risk based.  
**Further analyses should be developed over time before electing a specific ratio and its accompanying large decline thresholds.**

On the *NII SOT* ratio, we have concerns on how the threshold will be calibrated. We consider that data collected within the QIS (2021 and 2022 versions) are insufficient to properly assess the threshold as it is a point in time analysis in very specific circumstances (e.g. low / negative rate environment, massive quantitative monetary policies having ramifications on banks' balance sheet, sanitary crisis environment having an impact on customers and banks' balance sheet, application of floors specified in *EBA GL 2018/02* that are expected to changes).

We are very concerned by the methodology that *EBA* envisages to adopt to define a large decline threshold that will set for several years in the regulatory framework with potential consequences for the supervision, management and potential capital requirement. Identifying a large decline threshold based on a (few) points in time based on observations that banks don't have exactly the same *NII* in proportion to their Tier One (how come could they have?) and consequently some banks are identified as 'outlier' compared to the other has simply absolutely no basis. This envisaged methodology would confuse actual risk with the risk of not being like the other banks.

The role of *SOT*'s is to identify whether a bank may run too large an interest risk exposure in absolute terms, not in relation to the other banks. Supervision does not consist in expecting all banks to have similar exposure. We are not aware of any other regulatory requirement that aims at making sure that all banks are similar in their risk exposures.

Finally, as the *SOT*'s apply at both consolidated and individual basis in Europe, the threshold should be carefully calibrated so that it is consistent with the large scope of its application.

**In this context, we recommend delaying the definition of a large decline for *SOT NII* to benefit from further analysis that will be collected over time to make sure that it is consistent with the level of application and applies through the cycle (i.e. and not only 'point in time').**

It is reminded that it is not possible to make both *NII* and *EVE* insensitive to changes in interest rates. Banks have to strike their own balance on the range of positions of *NII* / *EVE* sensitivities they are willing to be. Hence, a bank may have larger *EVE* sensitivity for a lower *NII* sensitivity or conversely, a higher *NII* sensitivity for a lower *EVE* sensitivity. **The analysis of both *SOT EVE* and *SOT NII* will need to be assessed, without adopt a narrow-minded *SOT EVE*-only or *SOT NII*-only perspective. This should be clearly mentioned in the *RTS* to avoid confusion in the application of those *SOT*'s by supervisory authorities.**

#### ***Articulation between SOT's and Supervisory Analysis:***

- The *CP* should clarify that as *EVE* and *NII* sensitivities cannot be simultaneously reduced, the analysis of *SOT EVE* and *SOT NII* needs to be done in combination by competent authority.

**The *CP* should clarify that the *SOT*s serve as an indication for competent authorities only, as explicitly stated in article 98.5 of the *CRD5*. In that sense:**

- **no automatic supervisory measures should apply in case of crossing *SOT*'s thresholds. There should be no direct link between the *SOT*'s and the identification of internal capital that may be identified for *IRRBB*.**
- **no full integration of *SOT*s into the internal measurement and/ or management should be required.**
- **no (Pillar 3) disclosure obligation should be applied.**

***Question 3:*** *Do respondents consider that all the necessary aspects have been covered in the draft regulatory standard? Do respondents find the provisions clear enough or would any additional clarification be needed on any aspect?*

As described in our response to Question #2, the scope of application, i.e. at both consolidated and individual levels, should be carefully considered when defining common parametric assumptions and define large decline threshold.

- We would like to stress that the implementation of the *Guideline* will require a significant time to be carried out. Consequently, a sufficient period (at least 1 year) should be assigned before application. Ideally, the final application date of the *Guideline* should be aligned with the application of the technical standards, as the *EBA* suggested already in article 8.

Article 7 should be modified:

*This Regulation shall enter into force on **by the end of the** ~~the twentieth day following~~ **year after** ~~that of its publication in the Official Journal of the European Union.~~*