

The Hague

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**NWB BANK RESPONSE TO THE EBA CONSULTATION ON THE DRAFT IMPLEMENTING TECHNICAL STANDARDS AMENDING COMMISSION IMPLEMENTING REGULATION (EU) 2021/451 WITH REGARD TO IRRBB REPORTING**

NWB Bank welcomes the opportunity to reply to the consultation by the European Banking Authority (‘EBA’) on its draft reporting requirements for the assessment and monitoring of institutions’ Interest Rate Risk in the Banking Book (IRRBB).

In addition to answering the questions EBA raises in its consultation paper, we also draw EBA’s attention to general issues. In particular, we consider EBA’s choice to deconstruct (interest rate swaps) make it impossible to comply with the draft standards.

***General comments***

**Sign convention**: We consider the adopted sign convention artificial and unnatural. It is not intuitive to split cash flows from a single instrument into receipts and payments, assign positive signs to both, discount the positive numbers and then deduct the discounted value of receipts to derive a value. Nor is such a sign convention intuitive for determining the net income from an instrument that generates both payments and receipts of interest.

The adopted sign convention appears to be inspired by accounting consideration and not risk-management practices. This convention dates to a time when there were no computers and negative interest rates were inconceivable. EBA, by mentioning when the sign could still be negative, already provides the argument that the adopted sign convention can give rise to confusion.

As the aim of the ITS is to gather information on IRRBB, it should adopt a sign convention that reflects the contribution to levels of EVE and NII, not the way they would have been reported before the advent of modern computing technology.

**Deconstruction of linear derivatives**: Templates J 02.00 and J 03.00 require data for deconstructed swaps. Such information, commonly, is not available.

In theory, the cash flows from a plain-vanilla interest rate swap can be replicated by a short and a long position in a loan. It, however, is a fallacy to use those loans as substitutes for each leg.

* Whereas a loan has a principal, neither the swap, nor its legs exchange principal.
* The discounted value of the principal should not be considered.
  + Any attempt to value the floating-rate leg requires modelling the unknown future fixings of the index rate.
* The discounted value of cash flows from a loan contain the discounted principal that, normally, is a multiple of any single interest cash flow. The discounted value of an interest-rate swap and its legs only depend on interest cash flows that, normally, are a fraction of the notional amount underlying the contract.
* The carrying and exposure amount of the swap and its legs (e.g., fixed 0% against float, forward floating rates are both positive and negative and discount to zero, the term structure is flat at 0%) can be zero. If so, the yield is not defined.
  + In much the same way, a non-zero value that is close to zero can show a relatively large change in the discounted value even if the absolute change is minimal. As this is the denominator for the yield definition, the yield will show a large change as well.
* The yield of the floating-rate leg requires modelling of future fixings of the floating-rate index. In general, it is not clear what is meant by ‘yield’ for any floating-rate instrument, as this either is defined for the present fixing, or requires modelling of future fixings of the floating-rate index to determine expected net interest income from the instrument.

**Inclusion of interest cash flows in ‘notional repricing cash flows’**: article 5(b), in conjunction with article 4(f) of the RTS specifying supervisory shock scenarios (EBA/RTS/2022/10) would result in the re-investment of interest payments in addition to notional payments. This is reflected in the example in the explanatory box of article 13 of the RTS specifying standardised and simplified methodologies (EBA/RTS/2022/09). Not only does this result in a breach of the constant-balance-sheet assumption, it also could result in a deviation from an institution’s hedging policy. Consequently, the institution should not consider the outcome of the SOT or of the standardised methodology for its internal management system of IRRBB.

To illustrate this, consider a t-year granted loan with a coupon equal to the t-year annual swap rate at origination plus a spread that is hedged by a t-year swap with a fixed leg paying the same t-year annual swap rate and floating leg receiving the 12/i-month Euribor rate, where ‘i’ is the annual repricing frequency.

Once a year the institution should re-invest the annual swap rate plus spread in a t-year loan paying the prevailing t-year annual swap rate plus a ‘recent’ spread. It should enter into a fixed-leg of a t-year swap paying the t-year annual swap rate on the notional amount corresponding to the swap rate. It cannot invest in a swap, as a swap does not have a principal. It should enter into a floating-leg of a t-year swap receiving the 12/i-month Euribor rate on the notional amount corresponding to 1/i times 12/i-month Euribor rate.

At this time, the spread received on the loan is re-invested but remains unhedged. The outstanding swap with a floating leg and fixed leg that have different notionals.

On i-1 moments, the institutions must ‘re-invest’ the proceeds from the floating leg of the swap. There, however, is no guarantee that even the i ‘re-investments’ in floating legs add to the corresponding fixed leg.

In summary:

* the balance sheet size changes,
* there is no balance as the fixed and floating leg notional amounts of interest-rate swaps are no longer equal, and

the institution no longer adheres to its own hedging policy.

***Question 1****: Are the instructions and templates clear to the respondents? More specifically, do respondents consider that all definitions are unambiguous and accurate (e.g. linear and non-linear derivatives, contingent assets and liabilities, total assets/liabilities with impact on MV, etc)?*

We consider the instructions unclear.

Template J 02.00 lines 0180-0190 and 0540-0550 discern collateralised and non-collateralised derivatives. The definition refers to Regulation 648/2012. Legislation appears to lag market developments like settle-to-market derivative contracts. It, therefore, is unclear whether the definition of collateralised derivatives extends to contracts under which counterparties settle-to-market, rather than exchange collateral. Furthermore, where counterparties set a threshold that is not (yet) met, collateral is not exchanged. There, however, is the contractual obligation to exchange collateral when the threshold is met. It is unclear whether ‘cleared’ extends to a situation where there is a contractual obligation, but no collateral has (yet) been exchanged.

Template J 03.00 requires institutions to enter notional repricing cash flows (columns 0090-0270). It requires such data for derivatives, including ‘linear interest-rate derivatives’ (rows 0130, 0150, 0170-0200, 0490, 0510, 0530-0560, 0620, 0660). Annex XXIX refers to articles 1.1(1) and 1.1(2) of the EBA RTS on SOT. These articles define notional cash flows in terms of “amount of principal.” Linear interest-rate derivatives such as interest-rate swaps do not have such “principal.”

In general, the information on linear derivatives institutions are required to submit does not coincide with market practice. Where the instructions themselves may be “unambiguous and accurate” the information itself may have to be created for the sole purpose of filling these templates. See our response to Question 12.

The ITS requires institutions to provide ‘behavioural’ and ‘contractual’ figures. This can be ambiguous when a contract stipulates a party to pass through cash flows that are subject to behaviour of a third party. The behavioural option is not a characteristic of the contract itself.

***Question 2:*** *Do the respondents identify any discrepancies between these templates and instructions and the calculation of the requirements set out in the underlying regulation?*

In the executive summary to the consultation paper, EBA states “This new, harmonised reporting aims to bring the data quality required for assessing IRRBB risks on an appropriate scale of institutions, ….” The ITS, consequently, should limit itself to gathering information relevant for assessing IRRBB and not add reporting and supervisory data that bear no relevance to the management of IRRBB. See our response to Question 4.

The templates create an alternative reporting system that is a hybrid between accounting (carrying amounts, assets/liabilities), regulatory reporting (counterparty types, regulatory exposure value, deconstructed derivative legs, weighted average yield and remaining maturity, repricing schedules), and IRRBB measures.

Where accounting is a backward looking exercise, management of IRRBB, and risk in general, is a forward looking exercise. Consequently, institutions may not integrate their risk management and accounting applications. Requiring institutions to provide accounting data does not contribute to the stated aim of the ITS.

The treatment of derivatives and of linear interest-rate derivatives in particular carries the risk of obfuscating IRRBB. The ITS require institutions to provide non-existent notional repricing schedules. They require institutions to provide non-existent carrying amounts and exposure values for deconstructed legs of linear derivatives. They, furthermore, require institutions to provide a weighted average yield for those deconstructed legs.

The definition of “weighted average yield” requires division by the exposure value that may be zero for the instrument even if the counterparty is not in default, and does not exist for the individual deconstructed legs. A derivative contract that is settled to market, the carrying amount of the contract is 0.

***Question 3:*** *Do the respondents agree that the amended ITS fits the purpose of the underlying regulation?*

We do not agree the amended ITS fits the purpose of the underlying regulation. See also our response to Question 2.

The ITS should limit itself to IRRBB regulations and not gather information that bears no relevance to IRRBB and has been gathered through other reports. IRRBB arises from changes in market interest rates. Neither a regulatory “exposure value,” nor the counterparty are relevant for measuring IRRBB.

Additionally, when interest rate swaps are settled-to-market, the carrying amount of the contract and its legs are 0. Consequently, this item holds no information.

***Question 4****: How many full-time equivalent (FTE) employees does your institution expect to involve in the implementation for how many months in order to report in a compliant way? Please provide indications for specific templates and options relevant for your institution. Please also indicate whether the same implementation will be used by many reporting institutions such that costs are shared among them.*

The number of FTE employees the institution expects to involve depends both on the number of employed people that are knowledgeable and the availability of those people as the implementation of the ITS is not the only activity imposed by the legislator and regulator that draw on that same capacity.

In its present format, the templates require submission of IRRBB measures, accounting figures, and regulatory figures. The latter may be derived from IRRBB measures, but also, as is the case for “exposure value” and “weighted average yield” from accounting values. We do not have an integrated application for IRRBB measurement and accounting. This reflects the difference in scope of our accounting applications (backward looking) and IRRBB applications (forward looking). Combining information from such separate applications is a cumbersome task that will require more than the available FTE capacity.

The decomposition of linear derivatives, especially, is cause for concern, as neither our accounting application, nor IRRBB applications provides the required information. A separate model, therefore, should be implemented to be able to provide this information that we opine does not contribute to better monitoring of IRRBB.

Accounting applications and IRRBB applications, generally, are separate applications. An integrated report, therefore, will be unique to the institution.

***Question 5****: What technical and procedural dependencies does the implementation of the ITS imply for your institution? How do they affect the time schedule of the implementation?*

The most cumbersome and critical implications of the ITS include:

* (partial) integration of information from IRRBB and accounting applications;
* definition of regulatory measures such as “exposure value” and “weighted average yield” based on accounting values;
* modelling of decomposed legs of linear derivatives.

This reflects the lack of their contribution to better monitoring or effective management of IRRBB. For that reason, any requirement for procedural changes is questionable. As actual monitoring and effective management of IRRBB should have priority, we foresee difficulty in timely compliance with the draft ITS.

***Question 6****: Do respondents agree that the decision to simplify reporting templates is the best approach in implementing proportionality? In case you do not agree, what other proposal would be more efficient to reduce costs?*

As the Bank is not considered a ‘small and non-complex institution’ by its regulator, the Bank holds no view on the simplified templates.

***Question 7****: Do respondents perceive that the reporting requirements are proportionate for small and non-complex institutions? How could proportionality be further improved for these institutions? Particularly, does template J 08.00 on qualitative information add substantial reporting costs to these institutions? Is there some quantitative information contained in Templates J 05.00, J 06.00 and J 07.00 that is overly burdensome? Is the expected frequency for templates J 05.00, J 06.00, J 07.00 and J 08.00 feasible and proportionate?*

As the Bank is not considered a ‘small and non-complex institution’ by its regulator, the Bank holds no view on the implications for such institutions.

***Question 8****: Do respondents perceive that the reporting requirements are proportionate for institutions other than large institutions and small and non-complex institutions (‘other’ institutions)? Is there some quantitative information contained in Templates J 02.00, J 03.00 and J 04.00 that is overly burdensome? Is the expected frequency for templates J 02.00, J 03.00, J 04.00 and J 08.00 feasible and proportionate? How could proportionality be further improved for these institutions?*

Considering the lack of contribution to better monitoring or effective management of IRRBB, and the requirement to (partially) integrate IRRBB and accounting applications to provide “exposure value” and “weighted average yield”, we consider these reporting requirements non-proportionate and overly burdensome for any institution.

We further consider the requirement to decompose linear derivative instruments into separate legs non-proportionate for any institutions. Much of the information institutions should provide for those legs does not exist and requires implementation of a model for the sole purpose of filling the templates. This decomposition does not contribute to better monitoring or effective management of IRRBB. We consider these reporting requirements non-proportionate and overly burdensome for any institution.

***Question 9****:* Do respondents agree that the number of currencies requested in this reporting package is proportionate? Particularly for templates J 02.00 to J 08.00, do these amended ITS request right amount of information for currencies that have a limited/marginal contribution to the IRRBB?

Considering foreign-currency risk is not in scope of IRRBB, we opine the ITS should provide for an institution that fully and effectively hedges its exposure to foreign currencies and interest rates to limit its submission to its reporting currency. I.e., it should exempt such institution from submitting templates other than those in its reporting currency.

***Question 10****:* Do respondents currently compute their IRRBB figures, such as those in panels 03.00 and J 06.00, broken down by fixed/floating, for internal monitoring and/or supervisory reporting? If not, do respondents perceive that the reporting of templates J 03.00 and J 06.00 by fixed and floating rate instrument as a different dimension (i.e. in the Z axis) add substantial reporting costs with respect to different kind of solution? Would respondents propose a different approach to reduce the reporting costs (e.g breakdown in rows by fixed/floating rate instrument, or instead of having it in a different dimension duplicate the columns of the panel to fit fixed and floating in different columns)? Please elaborate.

We do not distinguish between fixed-rate and floating-rate instruments in our internal IRRBB reports. Our IRRBB applications, however, allow for distinguishing between such instruments and between interest-rate tenures of floating-rate instruments for the purpose of analysis of IRRBB.

To determine IRRBB from floating-rate instruments requires projecting future index rates up to maturity or using ‘repricing’ cash flows. Consequently, we must identify whether an instrument is a fixed-rate or floating-rate instrument. This, however, does not imply that such recognition is relevant for reporting purposes.

Where the templates require separate reporting for fixed-rate and floating-rate instruments, they do not discern between index rates underlying floating-rate instruments. Furthermore, the definition of floating-rate instruments in part I, section 3, of appendix XXIX does not extend to instruments indexed on benchmark rates with tenures of more than a year. As a consequence, the breakdown into fixed-rate and floating-rate instruments adds limited information. At the same time, the separate reporting of such instruments results in a lack of insight into overall IRRBB.

We use interest rate swaps to manage IRRBB exposures within our risk appetite. Payer and receiver swaps have both a fixed-rate and floating rate leg and do not belong to either category of instrument. Decomposing such swaps into fixed-rate and floating-rate legs does not provide a solution (see also our responses to Questions 1 and 2). Figures such as carrying amount, exposure value, weighted average yield do not exist for decomposed legs of interest rate swaps and require modelling them for the sole purpose of the ITS. Swaps that are settled to market have a carrying amount of 0, thus providing no information.

We expect that the bulk of the costs for implementing the ITS results from the separate reporting of fixed-rate and floating-rate (derivative) ‘instruments.’ We expect these costs to be excessive, especially considering they, do not add to the monitoring and effective management of IRRBB. We even foresee the separate reporting of fixed-rate and floating-rate ‘instruments’ resulting in incorrect and very volatile ‘weighted average yield’ figures. (See also our response to Question 2.)

We call on EBA to drop the separate reporting of fixed-rate and floating-rate exposures for the reasons given above. If EBA keeps to such separation, we would prefer a format in which such information is separated into columns within the same reporting panel for the reasons of:

1. costs: definition of a single template is both cheaper than definition of multiple templates;
2. reconciliation: adding columns allows for determining total exposures that can be reconciled with the combined exposure;
3. insight: having the information available in columns rather than separate templates allows for better insight into the total position; adding lines results in duplication that makes it more difficult to recognise total and specified IRRBB exposures.

***Question 11****:* Do respondents currently compute the figures in column 0020 for internal monitoring and/or supervisory reporting? If not, do respondents perceive that column 0020 adds considerable reporting costs in order to calculate these figures (please consider that it would only be reported for the aggregate of all currencies)? Would respondents propose a different approach to reduce the reporting costs? Please elaborate.

No, the Bank does not compute contractual amounts for internal monitoring or supervisory purposes. The Bank’s exposure to ‘behavioural options’ results from the contractual obligation of the counterparty to pass through cash flows from third parties that are subject to behavioural options. Legally, these ‘behavioural cash flows’ are contractual cash flows. (See also our response to Question 1.)

***Question 12****:* Does the inclusion of carrying amount and credit risk exposure amount cause implementation challenges? If yes, please describe the challenges

Not only does this pose challenges. We also consider these inappropriate, especially for the credit risk exposure amount. The subject of the ITS is IRRBB that excludes credit risk. Consequently, the ITS should not extend to the credit risk exposure amount.

We observe that, whereas template J 03.00 requires an institution to provide the ‘carrying amount,’ it does not contain information on the recognition of that ‘carrying amount.’ At best, therefore, the carrying amount is a very rough indication of the size of the exposure. As the components of the carrying amount depend on the accounting practice adopted by the institutions, nothing can be inferred from such amount. This, even more so, is the case for the carrying amount of derivatives. The carrying amount of an interest rate swap not even remotely has to reflect the underlying notional amount of the contract. Derivative contracts that settle to market will have a carrying amount of 0. (Please, also see our response to Question 1 relating to the definition of notional repricing schedules for interest rate swaps.)

Information on instruments are contained in an administrative system. Accounting and IRRBB applications draw on information retrieved from the administrative system. We do not have an integrated application for IRRBB measurement and accounting. This reflects the difference in scope of our accounting applications (backward looking) and IRRBB applications (forward looking). It also reflects the need to monitor IRRBB on a continuous basis. It also reflects the need to continuously monitor IRRBB when accounts are drawn up only periodically.

The carrying amount is information available from our accounting application. The regulatory reports draw on this application for reporting of the carrying amount and the credit risk exposure amount. The regulatory reports for IRRBB draw on IRRBB applications. We do not see a rationale for integrating these applications that have different scopes and periodicities solely for the purpose of adding information that does not pertain to IRRBB to an IRRBB report.

We, furthermore, remark that neither the carrying amount, nor the credit risk exposure amount exists for individual legs of derivatives of any kind.

***Question 13****:* What other types of methodologies for NII could be reported in row 0030?

The ITS and RTS fail to specify what is meant by the methodologies. Whereas ‘ duration gap’ and ‘ full revaluation’ can be interpreted in a discounting approach, NII is all but a discounting approach.

***Question 14****:* What other types of methodologies for NII could be reported in row 0030?

Linear approximation based on DV01.

***Question 15****:* What other risk-free yield curves used for discounting could be reported in rows 0320 and 0330?

For Euro: the sovereign curve could relate either to the institution’s country, a basket of sovereign issues, or the sovereign curve with the lowest yield.

***Question 16****:* Since it is necessary to collect qualitative information to complement the quantitative to get a full overview of the IRRBB risks from a supervisory perspective, do respondents see other IRRBB related aspects that might be necessary to cover?

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***Question 17****:* Do respondents see any issue about reporting the qualitative information in J 08.00? How do respondents consider this information in terms of usefulness and practicability?

Template J 08.00, line 0130, where the institution has a fully paid-up pension scheme and do not bear any risk, both answers hold true.

Template J 08.00, line 0140, where a loan is ‘non-performing’ under the regulatory definition but bears no risk of non-performance, as can happen with loans covered by a guarantee fund that takes over payments of interest and principal, there is no impact on IRRBB. Both answers hold true in such a case.

Template J 08.00, line 0150, the current description would include a commitment to grant a fixed rate loan for which the rate has yet to be fixed. It excludes a forward-starting floating-rate loan for which the rate has already been set. Considering settlement conventions, any floating-rate loan agreed on the report date or the preceding business day, likely, classifies as the latter.

Template J 08.00, line 0160, where the institution either has no retail exposure, or has no allowance for prepayment, both answers hold.

Template J 08.00, line 0170, where the institution either has no retail exposure, or has no allowance for early redemption, both answers hold.

Template J 08.00, line 0190, where the identification of core NMD balances is irrelevant due to the nature and purpose of NMDs, both answers hold.

Template J 08.00, line 0210, where the identification of core NMD balances is irrelevant due to the nature and purpose of NMDs, both answers hold.

Template J 08.00, line 0240, where the institution has no NMDs from financial customers classified as such, both answers hold.

Template J 08.00, line 0250, further possibilities are “Reduction of the duration gap between asset/liabilities by reducing the duration of the asset more than that of the asset,” “Increase of the duration gap by increasing the duration of assets more than the duration of liabilities,” plus a whole range of scenarios in which the (average) duration of assets and liabilities remain unchanged, but the exposures change in a way that the gap increases or decreases. Such analysis may be impractical.

Template J 08.00, line 0280, where the institution has no (direct) retail exposure both answers hold.

Template J 08.00, line 0290, where the institution has no (direct) retail exposure both answers hold.