Comments

Draft Guidelines on the management of interest rate risk arising from non-trading book activities

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The **German Banking Industry Committee** is the joint committee operated by the central associations of the German banking industry. These associations are the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), for the cooperative banks, the Bundesverband deutscher Banken (BdB), for the private commercial banks, the Bundesverband Öffentlicher Banken Deutschlands (VÖB), for the public-sector banks, the Deutscher Sparkassen- und Giroverband (DSGV), for the savings banks finance group, and the Verband deutscher Pfandbriefbanken (vdp), for the Pfandbrief banks. Collectively, they represent more than 1,700 banks.

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General comments

We appreciate the opportunity to comment on the Draft Guidelines and are pleased to provide our comments in the following.
We are highly critical of this revision. We regard the following points in particular as not acceptable:

- The EBA has exceeded its mandate as regards the content of the Guidelines
- There are many calculations that are not relevant for management purposes
- Proportionality is inadequately reflected

We generally take the view that the revision of the Guidelines constitutes a tightening of applicable European law. The content of the Guidelines means that **the EBA is exceeding its mandate**, and is anticipating the European legislative process in key areas. In particular, we reject the early introduction of the new supervisory outlier test (SOT), defined as a change in EVE greater than 15% of Tier 1 capital. We are also critical of the methodology underlying this, which should be reviewed in a QIS.

The revision already implements into EU law the Basel Standards on interest rate risk in the banking book (BCBS 368) to a very substantial extent. However, transposing the Basel Standards on interest rate risk in the banking book into EU law forms part of the current revision of the CRR/CRD. Accelerated implementation of the Basel Standards is not in conformity with the ongoing EU legislative process for the CRR/CRD. The draft CRD contains the relevant requirements and EBA mandates in the form of guidelines and technical standards (see Article 84(4) and (5) and Article 98(5a) of the draft CRD). We also wish to point out that the Basel Committee requirements apply to internationally operating banks, and we therefore do not see any need to already implement the Basel IRRBB requirements one-to-one for all banks in the EU at the end of 2018 in order to conform to the application date of the Basel Standards. The EBA should therefore not issue consultation papers or guidelines until the CRD mandates take effect.

In the course of the ongoing revision of the CRD, the EBA should be mandated in particular to develop a technical standard for determining the shock scenarios. The European Commission would then issue the standard with the approval of the European Parliament and the Council. Determining the shock scenarios as part of the revision of the EBA Guidelines circumvents the EU legislative process. In addition, the draft CRD states that the new requirements will only have to be applied two years after the CRD amendments take effect. These transitional periods for implementing the new standards are vital for the institutions; the time line for revising the EBA Guidelines runs counter to this objective and undermines the Commission’s requirements.

Unnecessary administrative effort for the institutions should also be avoided. However, we specifically see a possibility of this risk arising if the EBA implements the Basel Standards early

on its own initiative, without waiting for CRD V and the requirements it contains to come into force. We are therefore requesting the EBA to stop work on the revision of the EBA Guidelines until CRD V has come into force and the relevant EBA mandates have been issued.

Independently of our general criticism of the revision, however, we wish to take this opportunity to comment on the following points in order to support the discussion process within the EBA.

At a general level, we can understand the EBA’s goal of improving comparability for interest rate risk in the non-trading book between institutions at the national and international level. However, a rulebook with this objective must not lead to the diversity of the institutions and their individual situation being no longer taken into account. In addition, the requirements for the calculations to be performed must not be so extensive that the institution’s primary goal of running a business takes a back seat.

We do not believe that these requirements for a rulebook are met in the present draft. The **large number of calculations** and the analysis of too many risk measures leads to the loss of clear management triggers. This means that the Guidelines would not meet the goal of providing appropriate prudential supervision of interest rate risk.

The burden on institutions would be all the greater since both the imposed SOTs do not adequately model a bank’s interest rate risk. As we will explain later, the fact that the SOTs do model interest rate risk in an insufficient way is a result of standardised modelling requirements for heterogeneous banking products, the use of unsuitable shock scenarios and mixing together economic and accounting measures to derive own funds requirements.

The required calculations and internal reporting obligations are far too extensive without any additional benefit for interest rate management being evident (see e.g. paragraph 67). On the contrary: we regard some of the requirements as simply impossible to put into practice if banks are also expected to sustain their normal business operations. The proposed requirements are already inappropriate for large institutions and completely exaggerated for small institutions. We believe that it is vital to reduce for all institutions the qualitative and quantitative requirements for calculations and reporting obligations being proposed, and will draw attention to this as appropriate.

The examples described in the following serve to illustrate our arguments:

Various points in the Draft Guidelines require the explicit analysis of interest rate derivatives to manage interest rate risk (e.g. paragraphs 67(e) and 80). We believe that interest rate derivatives are a highly suitable means for managing interest rate risk. Measuring the risks associated with these derivatives is an integral component of the normal risk management process, exactly the same as analysing non-maturity deposits or implied optionalities. We are

therefore unable to identify the need for the required individual analyses. A separate analysis would be very labour-intensive without providing any additional knowledge. Additionally, they would rather increase the risk of misinterpretations, for example, when considering derivative exposures on a gross basis and disregarding necessary additional information provided by the institutions.

The simultaneous analysis of hedges of interest rate risk from both a risk and an accounting perspective required in several passages is meaningless. The risk perspective constitutes an ex ante analysis defined by the institution; for the accounting perspective, by contrast, the institutions have to use ex post measurement in accordance with the accounting framework (German GAAP, IFRS 9). This means that a hedge can be highly effective from a risk perspective, but this is not necessarily reflected in the accounting perspective. For this reason, all requirements relating to reconciliation or the need for a comparison (e.g. paragraphs 43(c), 102(f), …) should be deleted, because although both approaches are logical on a standalone basis, they cannot reasonably be compared.

We also criticise in this context that although the Draft Guidelines make general reference to the **proportionality principle**, this is not applied in any level of detail (e.g. in the reporting obligations in paragraph 63ff.). In order to avoid misunderstandings in supervisory assessment practice, we propose explicitly incorporating references to the proportionality principle in specific places.

We presume that the final versions of the three guidelines in the Pillar 2 framework (SREP, IRRBB, stress testing) will be aligned, because they all impact the requirements governing risk management and control processes.
In light of the abundance of requirements, we are surprised that the European institutions are being allowed an implementation period of less than one year.
Due to the complexity of the overall regulatory project, an implementation period of at least two years is absolutely vital. The implementation pressure that resulted from the original Basel timetable has become obsolete now that this timetable has been postponed.

Comments on the updated Guidelines on the management of interest rate risk arising from non-trading book activities (IRRBB Guidelines)

3 Background and rationale

Paragraphs 16/17
The SOTs are described as an important tool for competent authorities to monitor risk and perform peer reviews. We would like to emphasize that the existing application history does not change our criticism of the SOTs in their present form: the interest rate scenarios that determine the numerator represent extreme shocks and are thus not suitable for deriving relevant information. Criticism can also be levelled at the SOT denominator. Especially institutions that have a high level of hidden reserves and hence a tendency towards lower own funds are systematically disadvantaged. It cannot be the function of the supervisor to induce institutions to release hidden reserves and to increase their own funds by selling assets and realizing price gains – solely to reduce the prudential own funds requirements. In addition, a ratio is established between a parameter based on discounted cash flows – however it is calculated – and an accounting measure. This is fundamentally unsuited for determining a meaningful indicator of interest rate risk.

Using the standardised model therefore entails the risk of inappropriate capital surcharges; it is not suitable for use as a benchmark for institutions and groups of institutions; and it also endangers the professional development of the institutions and of risk management in general.

Paragraph 22:

We welcome the statement that SOTs are designed merely to serve the competent authorities as a tool to be used for an initial assessment of IRRBB. It is our understanding that this is to be used as a starting point for subsequent dialogue with the institution. At the same time, this means that increased capital surcharges may not result from the SREP solely because of the SOT. This applies equally to a case where the 20% threshold is exceeded in the old SOT. We propose placing a stronger emphasis on the decoupling of the SOT from supervisory measures – as implied in the text (see e.g. paragraph 22) – for both thresholds. The text of the Guidelines should also state that the institution’s overall situation must be taken into consideration in the decision on supervisory measures. The wording could be taken over from the requirements on limiting in section 4.3.3, paragraph 44(c).

In terms of perspective, if there is an intention for the SOT to be more important than as described above, it is vital for both the SOTs currently described to be replaced by a more appropriate SOT. Value at risk or at least an economic value measure as the denominator of the current SOTs are conceivable.

4 Draft Guidelines on the Management of Interest Rate Risk arising from non-trading book activities

2. Subject matter, scope and definitions

- **Question 1:**
  Are the definitions sufficiently clear? If not, please provide concrete suggestions and justify your answer.

  The definitions are only clear in parts:

  Interest rate risk arising from non-trading book activities: We would like to propose removing the words "current or prospective" from the definition. In particular, the prudential requirement for measuring interest rate risk in the non-trading book on the basis of an institution's economic value allows no more than an initial estimate of the current interest rate risk. The meaningfulness of simulations of future trends must be clearly called into question in the context of measuring EV. However, the present definition permits such a conclusion.
  We would also like to propose deleting the words "or have an impact on IRRBB". We believe there is a significant danger here that risks will be intermingled.

  Option risk: Exercise scenarios that depend not on the market rate of interest, but on the personal situation of the customer, are not described here. If these are not classified under interest rate sensitive instruments with an impact on IRRBB, they should be added here. These options are not interest rate sensitive, but still impact interest rate risk.

  Credit spread risk: Credit spread risk from non-trading book activities (CSRBB) is not a part of IRRBB but a standalone risk class. Therefore, it should not be regulated in the scope of the IRRBB guidelines. There are various ways to correctly model CSRBB, so institutions may analyse it separately from IRRBB or may model the two risk types together.
  Moreover – as already stated in comments on the corresponding Basel consultation paper (BCBS 319/368) – defining CSRBB as a residual is not appropriate.
  Overall, we believe that the newly added definition of CSRBB in the IRRBB guidelines goes too far. Even if the requirements for CSRBB are still very vague in the present document, they may well be spelled out in more detail in future versions. It should therefore be ensured that this definition is appropriate. We see a risk in the more sweeping definition that e.g. full fair value measurements of loans and the own credit spread risk will have to be included in EVE, or that margin risk from loans will fall under the definition of CSRBB for NII. In terms of substance, it would, for example, be appropriate to include CSRBB in EVE only if it results from exposures (especially securities) that are measured at fair value. The definition, however, should exclude the

own credit spread risk. Spread effects from securities should only be relevant (if at all) in NII in the context of IRRBB if the securities were acquired for purposes of interest rate management (i.e. normally securities held by treasury).

4.1 General provisions

- **Question 2:**
  Are the guidelines in section 4.1. regarding the general provisions sufficiently clear? If not, please provide concrete suggestions.

  Paragraph 18:
  As noted above, we wish to stress that CSRBB is not a part of IRRBB, but rather represents an independent risk class that, by definition, should not be mixed up with interest rate risk. This should follow clearly from the text.

- **Question 3:**
  Do you agree that cash flows from non-performing exposures (NPEs) should be net of provisions and treated as general interest rate sensitive instruments whose modelling should reflect expected cash flows and their timing for the purpose of EV and earnings measures? If not, please provide concrete suggestions and justify your answer.

  As a general rule, provisions should be reflected in risk measurement and management. However, there are various methods for including provisions. One example is to include them in interest cash flow, as described in the Draft Guidelines. However, because expected credit losses have of course not yet materialised and there is still a possibility that outstanding instalments will still be received, it must also be possible to reflect expected credit losses in credit risk. Therefore, there should be no fixed requirements about when and where provisions should be included; rather, they must be included to reflect the individual institution's management. Additionally, the procedure adopted should be reported to the supervisor so that the latter can perform an appropriate assessment of the reported figures for the calculated change in EVE following an interest rate shock.
  The situation is different if the credit loss has already occurred and there is no longer any contractual claim for payment of interest. In this case, the entire defaulted interest-related transaction is no longer part of the total cash flow. The default risk of troubled interest rate products is measured and managed in counterparty risk.
  Regardless of when and where provisions are included, there is also no hard-and-fast rule for the amount to be recognised. What is important is that there must not be any one-to-one recognition of accounting carrying amounts in order to avoid mixing business management and accounting rules. The cash flows expected by the bank must be recognised, regardless of the amounts actually written down. These may be both lower and higher than the write-downs (e.g. pull-to-par effect if a fair value is

recognised, ECB provisioning rules, and similar). It is important to understand that write-downs must be appropriately reflected. In this respect, the qualification "net of provisions" should be moderated in respect of the amounts to be recognised and modified to read "including provisions on a reasonable basis".

Moreover, clarification is requested as to whether the Guidelines refer to specific provisions only, or whether general provisions are being considered as well. General provisions would be difficult to allocate at a single exposure level within the IRRBB system. We would prefer an approach where the impact of provisions on cash flows can be calculated on an aggregated (e.g. portfolio) level.

There should also be a clarification that the requirement applies solely to the credit portfolio, and that IFRS provisioning or unwinding effects do not have to be included in the analysis.

Finally, for operational reasons we would like to propose that modelling of cash flows from NPLs should only be required when material and according to the proportionality principle. We would therefore appreciate a reference to proportionality in this paragraph.

Paragraph 20:
Considering "all elements and expectations" in the present Draft EBA Guidelines goes well beyond the bounds of feasibility. Many requirements are – taken by themselves – generally understandable, but only the calculations that are actually material for each institution should need to be performed. This is not sufficiently reflected in the qualification "implement […] commensurate with […] exposure to IRRBB".

4.2 Capital identification, calculation and allocation

- **Question 4:**
  Are the guidelines in section 4.2. regarding the capital identification, calculation, and allocation sufficiently clear? If not, please provide concrete suggestions and justify your answer.

  Paragraph 25:
  We support the requirement for institutions to use their own methodologies to suit their own situation. However, this paragraph must be viewed critically especially from the perspective of smaller institutions because it exemplifies the large number of calculations that these Guidelines are now demanding from the institutions. We would therefore appreciate a reference to the principle of proportionality in this paragraph. As a general point, the added value of the many analyses must be called into question. What is important is that the nature and number of the analyses must be guided by their ultimate relevance for management purposes.

Paragraph 26(d):
There should be no requirement to capture basis risk for any institutions for which basis risk is insignificant due to its very low level compared with overall interest rate risk.

Paragraph 26(e) and (f):
The meaning of subparagraphs (e) and (f) is not clear.

- **Question 5:** Do you agree with the list of elements to be considered for the internal capital allocation in respect of IRRBB to earnings in paragraph 30? If not, please provide concrete suggestions and justify your answer.

  We reject the amendments made in paragraph 30 for a number of reasons.
  The statements (e.g. on dividend policy) refer to ICAAP in general and are not specific to an individual risk type. We rather believe that the link between IRRBB and the dividend policy should be avoided. The revision of the dividend policy cannot be considered as losses. Payment of dividends is not directly correlated with the level of net interest income.

  The detailed requirements suggest that losses from movements in interest rates are particularly toxic compared with losses from other risk types. We cannot agree with this. Additionally, we regard the requirements as largely redundant. The precise difference between points a, b and d, e is not evident from practical experience. A particular problem in this context is that competent authorities (e.g. the ECB) and auditors generally require the institutions to demonstrate for each paragraph in the Guidelines how the requirements are implemented internally at the banks. This can be illustrated using the example of paragraph 30: we believe that it will be impossible to provide the required evidence for the new points cited in paragraph 30, in particular for NII risk in isolation. We strongly recommend reducing the text to its essence i.e. that institutions themselves are responsible for the allocation of Tier 2 capital taking account of a) the relative importance of interest income for their business model and b) the overall design of their ICAAP.

4.3 Governance

- **Question 6:**
  Are the guidelines in section 4.3. regarding the governance sufficiently clear? If not, please provide concrete suggestions and justify your answer.

  Paragraph 41:
  We think it is difficult to make a bank's management body directly responsible for decisions that can often only be made in day-to-day business operations. The management body can only define the overall framework. A good example is paragraph 41(c), because major hedging initiatives are developed and decided in the course of day-to-day business operations. It is neither practicable to define a suitable framework for this in advance, nor is it possible to involve the management body in these decisions in a timely manner. We would like to propose not giving the management body any direct responsibility for business operations. Paragraph 41(c) should be deleted.

  Paragraph 43(c):
  This paragraph is a good example of how the accounting and risk perspectives are mixed together. We would like to propose deleting the last sentence: "Institutions should also take into account the impact on profit and loss accounts of hedging interest rate derivatives whose effectiveness may be hampered under certain interest rate changes". When a hedging strategy is developed, there is an assumption that it will continue to be effective in the future. It does not make any sense to simulate its future effectiveness for all interest rate scenarios because the future ineffectiveness of any hedge accounting relationship results from potential larger differences in the actual vs. the assumed interest rates, and making reasonable assumptions in this respect is not possible.

  Section 4.3.4 c. (IT system and data quality):

  As a general remark, the requirements for IT systems should not be identical for all institutions, but should only cover the relevant material risks for the institutions in question. For example, basis risk is usually not relevant at small German banks. For this reason, it is not necessary for the corresponding IT systems to be capable of modelling this risk. This should be clearly formulated in the Guidelines. This is another example for the inadequate consideration of proportionality in the Draft Guidelines.

  Section 4.3.4 d. (Internal reporting):

  We believe that the in-depth requirements for internal reporting are, overall, too detailed and too far-reaching. At a fundamental level, we wish to refer to BCBS 239, where the reporting obligations are already addressed. The principle underlying BCBS 239 is that the level of detail decreases as hierarchy increases. This concept has been

completely lost in paragraph 67, for example. On the contrary: the requirements mean that the reports become bloated and hence lose their informative value (because of the necessity to report certain matters regularly to the management body although they cannot be used to generate any management triggers). A dramatic loss of acceptance of internal reporting to the management would be inevitable. Thus, the risk of mismanagement would be rather increased. Because of the complexity of the overall topic of IRRBB and the different business models, the institutions should have more freedom here to decide the form in which a breakdown of risks for the management body makes sense. The existing requirements in the Guidelines governing internal reporting were entirely adequate.

Some examples are listed in the following.

Paragraph 64:
We believe that the requirement to break down information by currency is not appropriate.

Paragraph 66:
This paragraph requires the results of model reviews and audits to be included in the (regular) reports. This should also be possible, for example, in the form of separate annual reports on model validation. We believe that the requirement to compare historical stress analyses against the current performance is (at least for earnings risk) unnecessarily time-consuming and not expedient. In contrast to economic value risk, earnings are only stressed over a certain period. In order to obtain meaningful backtesting, both the historical scenario and the corresponding balance sheet change would thus have to be perfectly modelled.

Paragraph 67:
The calculations and reporting obligations imposed here are far too complex and comprehensive. Not only that many of the required analyses are not helpful for management purposes – the mass of information means that the management triggers from the suitable indicators will actually be lost. The examples show clearly that in the case of such detailed minimum requirements, there can be no mention of applying the proportionality principle. We would therefore like to propose rewording the passage "they should include at least the following" to "accordingly, they may include the following".

Paragraph 67(e):
We believe that the obligation to always report the proportion of interest rate derivatives and Level 3 instruments in the regular reports to the management body (regardless of the importance of these positions or how stable their proportion is) is not appropriate. Any separate treatment of derivatives in the banking book seems to

misunderstand the impact of their role: hedging the IRRBB exposure. Institutions using derivatives to steer their day-to-day IRRBB exposure will possess a huge number of internal derivatives for steering purposes – the analysis of only one exposure type in the banking book does not show any risk in the banking book. The treatment of derivatives should therefore be aligned with other exposures in the banking book, such as mortgage loans. We do not understand the separate treatment of these hedging instruments for reporting purposes and would therefore like to propose deleting paragraph 67(e) in particular.

Paragraph 69:
From a purely practical perspective, the requirement for reports to be understood easily contradicts the requirements of paragraphs 66 and 67, which automatically result in complex reporting.

Paragraph 77:
It is important to understand the models used, their strengths and weaknesses, their consistency with other methodologies used and the assumptions and their consequences. However, adequate consideration should be given to the principle of proportionality especially with regards to the understanding of the analytics, including by permitting external certification.

4.4 Measurement

- **Question 7:**
  Are the guidelines in section 4.4. regarding the measurement sufficiently clear? If not, please provide concrete suggestions and justify your answer.

  The requirements for the components to be modelled are excessive as a whole. They are almost impossible to meet, even at large institutions with appropriate specialised departments. In addition to reducing the requirements imposed for all institutions, the principle of proportionality must be taken into account to a greater extent especially in this section.

  Paragraph 80:
  We do not understand the reasons behind the reference to derivatives. The use of derivatives does not result in any interest rate risk that has to be measured separately. Interest rate risk is analysed as a whole. Derivatives are used to manage this risk. We would therefore like to propose deleting the clause "(ii) the IRRBB of their banking book interest rate derivatives".

  Paragraph 81:
  We presume that a "transparent methodology for the identification…" means a

description and justification of the approach and would like to propose wording this accordingly.

Paragraph 83:
We believe that institutions should use their own assumptions and methods that are suitable for the specific situation of the institution concerned. This is the only way to calculate a realistic risk – something that is not possible with a one-size-fits-all approach. We do not understand in this context how the SOTs, which cannot accurately capture the risk of the institutions, can be integrated as complementary measures in risk measurement. The use of two additional measures that are not meaningful to estimate the interest rate risk exposure does not constitute any added value for the institutions, but merely increases calculation effort and the complexity of decision-making (see also Question 4) and may lead to adverse management incentives hampering the appropriate internal modelling of interest rate risk.

Paragraph 84:
Own measures that are appropriate for the risk to be measured but are not listed in Annex I should be allowed to replace the methods described in Annex I. Please therefore add this to the paragraph.

Paragraph 86:
The descriptions of automatic and behavioural options are incorrect: we would like to propose limiting automatic options to caps and floors. Swaptions or prepayment options embedded in wholesale assets are very often determined by behavioural factors and should therefore not be mentioned in the context of automatic options.
Behavioural options are not merely limited to smaller retail customers. There are also wholesale customers who base their decisions on other factors than the mere interest rate change. This needs to be addressed in order to make good management decisions. The definition of behavioural options therefore needs to be widened.

Paragraph 88:
Basis risk is not relevant for all institutions (see also Question 1). We are requesting the corresponding qualification of this requirement.

Paragraph 91:
We believe that the old wording ("may supplement […], for instance:") was sufficient. We would therefore like to propose restoring it in order to allow application of the proportionality principle.

Paragraph 97:
The calculation of any second round effects is not capable of implementation. The wording should at least be qualified (e.g. "major second round effects").

Paragraph 102(f):
The future hedge accounting ineffectiveness is by definition difficult to model as only the expectation of an effective hedge relationship allows for future hedge accounting. The effectiveness of hedge accounting should be left outside the simulation. For this reason, we would like to propose deleting paragraph 102(f).

Paragraph 104(a):
It is not practicable to model all the parameters cited. Rather, it should be possible to select one or more parameters with a significant influence that will be used in the modelling. The reflection of all behavioural options is not practicable and not target-aimed. The obligation should be restricted to essential options.

Paragraph 104(b):
We presume that 104(b) does not mean that there is a requirement to use elasticities, but rather that the term "elasticity" is being used to refer to the speed of the adjustment of product rates. The weaknesses of elasticities (e.g. insufficient tradability) are known, which is why many institutions use another model here. The use of different models in an institution leads to inconsistencies in management. A single model for quantification is sufficient. What matters is the quality of the model. We therefore suggest retaining the original wording ("speed/elasticity") or replacing the word "elasticity" by "speed", which is valid across models.

Paragraph 105(a):
It should be clarified here that it may also happen that a customer may pay at the contractual date, but e.g. only part of the outstanding amount (e.g. 30%). In this case, too, the transaction would be managed as a behavioural transaction.

Paragraph 106:
Overall, the requirements far exceed the requirements of BCBS 368. In particular interest rate risk is mixed together with liquidity risk. We are requesting that this paragraph be modified accordingly.

Examples include:

Paragraph 106(a):
It is not evident why inflows and outflows to and from individual accounts should have anything to do with the institution's interest rate policy for a product. Given an overall constant product volume and a constant rate of interest, in an extreme case 100% of the balance could be withdrawn daily by customers and reinvested by other customers without having any effect on the interest rate risk of the product in question.

Paragraph 106(g):
See Question 8.

Paragraph 106(h):
We are requesting clarification that only realistic stress scenarios for interest rate risk, and not for example – as required in paragraph 106(g) – an overnight outflow of demand deposits have to be modelled. That would be neither realistic, nor would it primarily be interest rate risk.

- **Question 8:**
  Do you consider the comparison between EV metrics calculated using contractual terms for NMDs with the EV metrics calculated with behavioural modelled assumptions sensible and practical? Please justify your answer.

  Paragraph 106(g):
  No, because there is no connection between the contractual terms and the behavioural assumptions for NMDs.
  Whereas contractual terms are an unrealistic case of a right that theoretically applies to all customers, the behavioural assumptions primarily involve modelling repricing using a trade executed on the money and capital market as precisely as possible. On the one hand, the margin remains a variable that is as constant as possible. On the other, interest rate risk from this product is optimally eliminated.
  A comparison of both variables (contractual term and model) is thus not necessary, nor does it lead to any understanding in terms of interest rate risk. In light of the overall expected additional effort, all unnecessary calculations should be avoided.

4.5 Supervisory outlier test

- **Question 9:**
  Are the guidelines in section 4.5. regarding the supervisory outlier test sufficiently clear? If not, please provide concrete suggestions and justify your answer.

  The SOT systematically disadvantages institutions that have created a high level of assets in their interest rate book thanks to a stable investment policy. As a rule, these assets do not lead to a 1:1 increase in capital. The higher the hidden reserves generated by the investments, the greater the interest rate coefficient of the SOT will be. This means that particularly stable banks (with a high net asset value) are especially impacted. As a result, the outlier criterion cannot serve as an objective measure for assessing IRRBB in a cross-country comparison. This indicator does not become more meaningful if the numerator is based on six scenarios that all represent extreme stress cases and the denominator is still an accounting measure (whether own funds or Tier 1 capital). This does not change the effect described. If these indicators

continue to be used to classify interest rate risk, no automatic mechanism can be based on them from which an own funds requirement can be derived.

In addition, we wish to point out that requiring two SOTs anticipates the European legislative process. The EBA does not have a mandate to do this, in particular by means of a guideline. We are therefore not in favour of the coexistence of two prudential indicators.

We wish to point out again that this results in the absurd situation that, in addition to the required basically reasonable institution-specific modelling exercises, two SOTs also have to be calculated from which – as explained above – no meaningful management triggers can be derived for the institution due to their design.

Specifically we are opposed to the following requirements:

Paragraph 113(d):
We believe that the requirement for behavioural assumptions that depend on the interest rate scenario is not appropriate – after all, behavioural assumptions are **in**dependent of interest rates. As an example, we wish to point out that, especially for the overnight shock modelled for the SOT, there cannot be any change in behaviour. Even if there were a slight dependence on interest rates, a direct change in behaviour would be extremely unrealistic. In addition, this requirement blatantly contradicts the general demand for comparability.

Paragraph 113(f):
What is meant by "repricing" here? Principal is automatically remeasured when the interest rate risk cash flow is remeasured at overall bank level following the simulated interest rate shock. After all, this is precisely the idea behind determining a change in EVE.

Paragraph 113(n):
We would welcome a situation where not only discounting using a risk-free yield curve per currency were to be permitted, but also discounting using several yield curves per currency. We believe that it is appropriate for institutions – as before – to be able to use the yield curves they use for their internal management for the SOT as well. We wish to draw attention to the future disclosure requirements at this point. It will be difficult to explain the differences between internal and external calculations resulting from this requirement.

Paragraph 113(o):
The five-year cap for NMDs required for the EU represents clear gold plating compared with the Basel requirements. We therefore continue to forcefully reject this

requirement. The stiffer requirement added to this Draft excluding financial institutions from behavioural deposits is based on the assumption that financial institutions always act as perfect economic agents. It has been repeatedly shown in practice that this is not the case. Insurers and pension funds in particular do not always make their investment decisions merely on the basis of interest rate changes. We therefore clearly reject this stiffer requirement.
Additionally, we presume that the cap will be calculated as a volume-weighted average for all liabilities. We would ask you to clarify this.
We would like to emphasise that the information contained in the numerator of the SOTs can only be comparable if there are no standardised requirements for modelling NMDs. Overly restrictive requirements produce meaningless results, especially in the case of interest rate risk (diversity of business models, heterogeneous customer behaviour in Europe due to cultural and legal factors).

- **Question 10:**
  Is the proportionality adequately reflected in the guidelines, in particular in relation to the transitional period for SREP category 3 and 4 institutions and the frequency of calculation for the additional outlier test under paragraph 112?

  We would like to declare a very clear “No” at this point. The reason is that the prudential proportionality principle means not only marginal relief due to reduced regulatory reporting obligations, but also qualitative and quantitative relief overall. This is also especially the case if the indicators to be captured do not provide any objective added value for supervisory monitoring. A single meaningful economic indicator such as value at risk is much better and also adequate compared with various indicators or measures that – already because of their mere quantity – do not have any relevance for management.

- **Question 11:**
  If relevant, do you manage interest rate risk arising from pension obligations and pension plans assets within the IRRBB framework or do you cover it within another risk category (e.g. within market risk separately from IRRBB, etc.)?

  Paragraph 113(e):
  It is generally correct that pension obligations generate future cash flows (expenditures). The question that needs to be asked, however, is whether the present value (the current price of the obligation) is materially affected by a change in interest rates. This will certainly be the case if the amount and term of the pension obligation are fixed in the same way as a fixed-rate transaction. For example, if the pension agreement has a term of 10 years and the amount is already fixed today, the pension payment will thus neither be continued after the end of those 10 years without a

renegotiation, nor will the payment be terminated early due to the death of the beneficiary. Such agreements are uncommon in Germany.
Rather, the pension obligation is normally linked to general wage trends/inflation and/or other economic variables. Additionally, the longevity of the recipient or their spouse or partner is another factor.
This shows clearly that the primary factor determining the value is not only the interest rate, but that other factors have a much stronger impact on the economic value and the risk associated with it.
From a management perspective, it seems questionable whether a fixed-rate investment based on the estimated pensionable age of the beneficiaries really makes sense. If this investment were to be made at today's low rates, and inflation were to emerge over time due to pay increases, a risk would have arisen for the bank.
It would make more sense to secure the pension entitlements to match the bank's long-term investment strategy, i.e. by making the investment not only in interest-bearing securities, but also in real estate (funds) and equities.
As a consequence, from a management perspective, risk stemming from pension obligations should be included in the IRRBB-framework at most with its interest-driven part or should be considered as a whole in a separate position.

- **Question 12:**
  Which treatment of commercial margins cash flows do you consider conceptually most correct in EV metric, when discounting with risk free rate curve: a) including commercial margins cash flows or b) excluding commercial margins cash flows? Please justify your answer.

  The current practice varies. Both methods are used by German institutions - in line with the respective internal management system. Both approaches are consistent and thus "most correct". EBA should, in accordance with the requirements of BCBS368, allow the equal application of both procedures. From our point of view, this would be the only way to counteract the ever-widening split of reporting and internal management.

- **Question 13:**
  Are your internal systems flexible enough to exclude margins for the purpose of calculating EV measures for the supervisory outlier test? If not, what would be the cost to adapt your systems (high, medium, low)? Please elaborate your answer.

  This question cannot be answered unequivocally for the German banking market. Most significant institutions have already completed this separation in their internal systems. However, the systems of the majority of less significant or even medium-sized institutions are not able to exhibit this flexibility. The IT costs for those institutions would be extremely high because the corresponding adaptations to the upstream systems would have to be made. There is also no unequivocal answer to the question of

whether the calculation is better with or without margins from a management perspective. We are therefore very clearly against the proposal to exclude margins from the prudential calculation mandatorily for all banks.

- **Question 14:**
  Do you consider the level of the proposed linear lower bound as described in paragraph 113 (k) appropriate? If not, please provide concrete suggestions and justify your answer.

  We understand the reason for specifying an interest rate floor, but wish to draw attention to one aspect. The drawback of applying a post-shock interest rate floor can be illustrated by the following example:
  If the interest rate before the shock is lower than the floor and the scenario shifts it lower, the described logic means that first the shock and then the floor would be used. In this example, that means that there is a de facto upward shift. In order to prevent misunderstandings and to ensure a proper and timely implementation we are therefore asking for clarification of this requirement.
  As the floor, we propose using the lower of the interest rate existing at the observation date and the rate following from the definition above. For example, if the interest rate is −100 bp and the floor is -90 bp, it will not be shifted any lower by the downward shock, but also not any higher. This approach is already applied in practice by the German supervisor.

- **Question 15:**
  Do you consider the minimum threshold for material currencies included into the supervisory outlier test (5% for individual currency and minimum 90% of the total non-trading book assets or liabilities) sufficient to measure IRRBB in term of EVE? If not, please provide concrete suggestions and justify your answer.

  Paragraph 113(l):
  It is our understanding that only currencies that exceed a materiality threshold of 5% are included. However, the reference variable for the materiality threshold is unclear. Potential values here include the nominal value or the market value, for example. However, with respect to derivative positions, the nominal would be inadequate and the market value preferable.

- **Question 16:**
  When aggregating changes to EVE in the supervisory outlier test, does the disregarding of positive changes to EVE have a material impact on the calculation of the supervisory outlier test?

Paragraph 113(m):
This approach is not appropriate because the interactions between currencies and interest rates are not adequately taken into consideration. Merely showing negative EVE changes is arbitrary and extremely conservative. It does not reflect the bank's risk position and, for example, punishes banks whose FX funding is fully hedged by FX derivatives. The objective should be a scenario-specific analysis. We are therefore requesting the modification of the requirements.