Brussels, XXX
[…](2022) XXX draft

COMMISSION DELEGATED REGULATION (EU) …/...

of XXX

on Supplementing Directive 2013/36/EU, amended by Directive (EU) 2019/878, of the European Parliament and of the Council with regard to regulatory technical standards to specify the supervisory shock scenarios, the common modelling and parametric assumptions and the definition of a large decline, for the purposes of the supervisory outlier tests of the exposures of institutions to the interest rate risk arising from non-trading book activities and their impact on net interest income and economic value of equity

(Text with EEA relevance)

EXPLANATORY MEMORANDUM

1. CONTEXT OF THE DELEGATED ACT

Article 98(5a) of the Directive 2013/36/EU ('the Directive') empowers the Commission to adopt, following submission of draft regulatory technical standards ('RTS') by the European Banking Authority ('EBA'), and in accordance with Articles 10 to 14 of Regulation (EU) No 1093/2010, delegated acts to specify the supervisory shock scenarios, the common modelling and parametric assumptions and the definition of a large decline, for the purposes of the supervisory outlier tests of the exposures of institutions to the interest rate risk arising from non-trading book activities and their impact on net interest income and economic value of equity.

In accordance with Article 10(1) of Regulation No (EU) 1093/2010 establishing the EBA, the Commission shall decide within three months of receipt of the draft standards whether to endorse the drafts submitted. The Commission may also endorse the draft standards in part only, or with amendments, where the Union's interests so require, having regard to the specific procedure laid down in those Articles.

2. CONSULTATIONS PRIOR TO THE ADOPTION OF THE ACT

In accordance with the third subparagraph of Article 10(1) of Regulation No (EU) 1093/2010, the EBA has carried out a public consultation on the draft RTS submitted to the Commission in accordance with Article 98(5a) of the Directive A consultation paper was published on the EBA internet site on 2 December 2021, and the consultation closed on 4 April 2022. Moreover, the EBA requested the Banking Stakeholder Group set up in accordance with Article 37 of Regulation No (EU) 1093/2010 to provide advice on them. Together with the draft technical standards, the EBA has submitted an explanation on how the outcome of these consultations has been taken into account in the development of the final draft technical standards submitted to the Commission.

Together with the draft technical standards, and in accordance with the third subparagraph of Article 10(1) of Regulation No (EU) 1093/2010, the EBA has submitted its impact assessment, including its analysis of the costs and benefits, related to the draft technical standards submitted to the Commission.

3. LEGAL ELEMENTS OF THE DELEGATED ACT

The provisions of this delegated act specifies the supervisory shock scenarios, the common modelling and parametric assumptions and the definition of a large decline, for the purposes of the supervisory outlier tests of the exposures of institutions to the interest rate risk arising from non-trading book activities and their impact on net interest income and economic value of equity.

These draft RTS ensure continuity and compliance with the relevant international standards. The definitions, elements and steps of methodology set out are built upon those established in the EBA Guidelines on the management of interest rate risk arising from non-trading book activities and those established in the standardised methodology of the Basel Committee on Banking Supervision of April 2016.

These draft RTS aim to specify common modelling and parametric assumptions that institutions should use for the purposes of the calculations of the cited EVE and NII. To that end, these draft RTS set that for the calculation of the NII, a constant balance sheet assumption over a one-year time horizon should be used while, for the calculation of the EVE,

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.

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, these draft RTS set out that commercial margins and spread components shall be included in the calculation of the NII, but for the calculation of the EVE, institutions shall proceed in accordance with their internal management and measurement approach for interest rate risk in the non-trading book.

COMMISSION DELEGATED REGULATION (EU) …/…

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on Supplementing Directive 2013/36/EU, amended by Directive (EU) 2019/878, of the European Parliament and of the Council with regard to regulatory technical standards to specify the supervisory shock scenarios, the common modelling and parametric assumptions and the definition of a large decline, for the purposes of the supervisory outlier tests of the exposures of institutions to the interest rate risk arising from non-trading book activities and their impact on net interest income and economic value of equity

(Text with EEA relevance)

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC, as amended by Directive (EU) 2019/878 of the European Parliament and of the Council of 20 May 2019,[1] and in particular Article 98(5a) thereof,

Whereas:

(1)   The specification of the supervisory shock scenarios set out in this Regulation builds on the relevant specification established by the Basel Committee on Banking Supervision (BCBS)[2] and already reflected in the EBA Guidelines on the management of interest rate risk arising from non-trading book activities[3] that apply from 30 June 2019 and will be repealed following the adoption of this Regulation.

(2)   For the purposes of the calculations of the cited economic value of equity and net interest income, this Regulation seeks to specify common modelling and parametric assumptions 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.

(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

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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.

(4) According to the BCBS standards, any outlier test mandated in addition to the EVE outlier test should use a threshold to identify outlier banks that is at least as stringent as the one applied to the EVE outlier test. To achieve this, a common methodology, that remains appropriate in different interest rate environments and that considers the business model and risk profile of institutions, should be designed, and used under the supervisory review process, to identify those institutions that would suffer a large decline for the purpose of the net interest income (NII) outlier test and generate a sample of outlier institutions proportionate to the one generated by the EVE outlier test. In addition, such methodology should incentivise institutions to closely monitor the effects of interest rate risk shocks resulting from exposures in the non-trading book on their net interest income (NII) from a 2.5% decline of their Tier 1 capital. To ensure consistency, the definition of a large decline for the purpose of the NII outlier test should therefore reflect these objectives.

(5) This Regulation is based on the draft regulatory technical standards submitted to the Commission by the European Banking Authority.

(6) EBA has conducted an open public consultation on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093/2010.

HAS ADOPTED THIS REGULATION:

Article 1
Supervisory shock scenarios

1. The six supervisory shock scenarios referred to in Article 98(5), point (a) of Directive 2013/36/EU shall be the following:

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

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

   (c) steepener shock, where there is a steepening shift of the yield curve, with negative interest rate shocks for shorter maturities and positive interest rate shocks for longer maturities;

   (d) flattener shock, where there is a flattening shift of the yield curve, with positive interest rate shocks for shorter maturities and negative interest rate shocks for longer maturities;

   (e) short rates shock up, with larger positive interest rate shocks for shorter maturities to converge with the baseline for longer maturities; and

   (f) short rates shock down, with larger negative interest rate shocks for shorter maturities to converge with the baseline for longer maturities.

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.

3.   The supervisory shock scenarios referred to in paragraphs 1 and 2 shall be calculated on the basis of the currency-specific specified sizes of interest rate shocks set out in ANNEX I and Article 2 and shall apply at least to the exposure of institutions to the interest rate risk arising from non-trading book activities denominated in each currency separately for which the institution has positions where the accounting value of financial assets or liabilities denominated in a currency amounts to 5% or more of the total non-trading book financial assets or liabilities, or less than 5% if the sum of financial assets or liabilities included in the calculation is lower than 90% of total non-trading book financial assets (excluding tangible assets) or liabilities.

Article 2
Currencies not referred to in ANNEX I

1.   To calibrate specified sizes for interest rate shocks for currencies not referred to in ANNEX I, the following shall apply:

(a)   Institutions shall first calculate the daily average interest rate by collecting a 16-year time series of daily 'risk-free' interest rates, without instrument-specific or entity-specific credit spreads or liquidity spreads, for each currency for the maturities 3M, 6M, 1Y, 2Y, 5Y, 7Y, 10Y, 15Y and 20Y and then calculate the arithmetic average interest rate for each currency c across all observations in the time series and for all maturities. The result shall be a single measure per currency.

(b)   If the average interest rate calculated as per point (a) for the first seven years is greater than 700 basis points, then data from the most recent 10 years or until when data is available shall be used; if not, the full 16-year time series of data shall be used.

(c)   The parallel, short and long Interest rate shock by currency shall be derived from applying the relevant global shock parameter from Table 1 to the average interest rate calculated in point (a).

Table 1. Baseline global interest rate shock parameters

Parallel	$\bar{\alpha}_{parallel}$	60%
Short	$\bar{\alpha}_{short}$	85%
Long	$\bar{\alpha}_{long}$	40%

(d)   Institutions shall apply a floor of 100 basis points as well as variable caps of 500 basis points for the short-term shock, 400 basis points for the parallel shock and 300 basis points for the long-term shock, respectively.

(e)   The set of interest rate shocks by currency shall then be rounded to the nearest 50 basis points.

2.   The calibration referred to in paragraph 1 should be performed at least every five years.

Article 3
Parametrisation of supervisory shock scenarios

For each currency c the specified size of the parallel, short and long shocks to the 'risk-free' interest rate, the following parameterisations of the six supervisory shock scenarios shall be applied:

(a) *Parallel shock for currency c*: A constant parallel shock up or down across all time buckets:

$$\Delta R_{parallel,c}(t_k) = \pm \bar{R}_{parallel,c}$$

(b) *Short rate shock for currency c*:

$$\Delta R_{short,c}(t_k) = \pm \bar{R}_{short,c} \cdot e^{\frac{-t_k}{4}},$$

where t_k is the midpoint (in time) of the kth time bucket.

(c) *Long rate shock for currency c*:

$$\Delta R_{long,c}(t_k) = \pm \bar{R}_{long,c} \cdot \left(1 - e^{\frac{-t_k}{4}}\right)$$

(d) *Rotation shocks for currency c*:

$$\Delta R_{steepener,c}(t_k) = -0.65 \cdot |\Delta R_{short,c}(t_k)| + 0.9 \cdot |\Delta R_{long,c}(t_k)|;$$

$$\Delta R_{flattener,c}(t_k) = +0.8 \cdot |\Delta R_{short,c}(t_k)| - 0.6 \cdot |\Delta R_{long,c}(t_k)|.$$

Article 4
Changes in the economic value of equity (EVE)

Institutions shall reflect in their calculation of the economic value of equity as referred to in Article 98 (5), point (a) of Directive 2013/36/EU, the following common modelling and parametric assumptions:

(a) All non-trading book positions from interest rate sensitive instruments shall be taken into account.

(b) Small trading book business, as defined by paragraph 1 of Article 94 of Regulation (EU) No 575/2013, shall be included unless its interest rate risk is captured in another risk measure.

(c) All CET1 instruments and other perpetual own funds without any call dates shall be excluded from the calculation of the supervisory outlier test.

(d) Institutions shall reflect automatic and behavioural options in the calculation. Institutions shall adjust key behavioural modelling assumptions of interest rate sensitive instruments to the features of different interest rate scenarios taking into account the proportionality and materiality thresholds set out in Articles 7(12), 8(2), 9(4), 11(3) and 21(1) of [XXX – *Final Name of the RTS SA*].

(e) Pension obligations and pension plan assets shall be included unless their interest rate risk is captured in another risk measure.

(f) The cash flows from interest rate sensitive instruments shall include any repayment of principal, any repricing of principal and any interest payments.

(g) Institutions with a non-performing exposures ratio of 2% or more shall include non-performing exposures as general interest rate sensitive instruments whose modelling

should reflect expected cash flows and their timing. Non-performing exposures shall be included net of provisions. For these purposes, non-performing exposures are determined by debt securities, loans and advances classified as non-performing in accordance with Article 47a(3) of Regulation 575/2013, while the non-performing exposures ratio is calculated as the amount of non-performing exposures divided by the amount of total gross debt securities, loans and advances calculated at the level of the institution.

(h)   Institutions shall include instrument-specific interest rate caps and floors.

(i)   Commercial margins and other spread components in interest payments in terms of their exclusion from or inclusion in the cash flows shall be treated in accordance with the institutions' internal management and measurement approach for interest rate risk in the non-trading book. If commercial margins and other spread components are excluded, institutions shall (i) use a transparent methodology for identifying the risk-free rate at inception of each instrument; (ii) use a methodology that is applied consistently across business units; (iii) ensure that the exclusion of commercial margins and other spread components from the cash flows is consistent with how the institution manages and hedges IRRBB and (iv) notify their exclusion to the competent authority.

(j)   The change in EVE shall be computed with the assumption of a run-off balance sheet, where existing positions mature and are not replaced.

(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.

(l)   When calculating the aggregate change for each interest rate shock scenario, institutions shall add together any negative and positive changes occurring in each currency. Currencies other than the reporting currency shall be converted to the reporting currency at the ECB spot FX rate on the reference date. 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%. Weighted gains shall be recognised up to the greater of (i) the absolute value of negative changes in EUR or ERMII currencies and (ii) the result of applying a factor of 50% to the positive changes of ERMII currencies or EUR, respectively.

(m)   For discounting, an appropriate general 'risk-free' yield curve per currency shall be applied (e.g., an OIS curve). That yield curve shall not include instrument-, sector- or entity-specific credit spreads or liquidity spreads.

(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.

Article 5
Changes in the net interest income

(a)   Institutions shall reflect in their calculations of the net interest income as referred to Article 98 (5), point (b) the following common modelling and parametric assumptions: Interest income and interest expenses over a one-year horizon shall be considered regardless of the maturity and the accounting treatment of the relevant interest rate sensitive non-trading book instruments.

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

(c)   Institutions shall include commercial margins and other spread components.

(d)   Institutions shall compute the change in the net interest income 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.

Article 6
Identification of outlier institutions under the NII calculation

1.   For the purpose of Article 98(5), point (b), of Directive 2013/36/EU, competent authorities shall rank institutions based on the decline of their one-year net interest income as a proportion of their respective Tier 1 capital, resulting from the application of any of the two supervisory shock scenarios set out in Article 1. When establishing a ranking, competent authorities shall take into consideration the business model and risk profile of institutions determined as a result of the supervisory review and evaluation in accordance with Article 97 of Directive 2013/36/EU.

        Based on that ranking, competent authorities shall select a sample of institutions with the largest declines that is proportionate to the sample of institutions resulting from the application of the shocks referred to in Article 98(5), point (a), of Directive 2013/36/EU.

2.   An institution shall be deemed to experience a large decline for the purpose of Article 98(5), point (b) of Directive 2013/36/EU, if it meets both of the following conditions:

   (i)   the institution was selected in accordance with the second subparagraph of paragraph 1;

   (ii)   the decline in the institution's one-year net interest income is larger than or equal to 2.5% of its Tier 1 capital.

3.   For the calculation of the decline in paragraph 1, the following formula shall be applied:

$$Level\ of\ NII\ decline = \frac{NII_{shock} - NII_{baseline}}{Tier\ 1\ Capital}$$

Article 7
Entry into force

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

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

For the Commission
The President