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## **EBF response to EBA consultation paper (EBA/CP/2021/20) on disclosure of information on exposures to interest rate risk on positions not held in the trading book in accordance with Article 448 of Regulation(EU)No 575/2013**

### **Background**

**Level 1 regulation** (cf. appendices 1 and 2 for the referred articles, notably Article 448, CRR 2)

The Article 448 of the Capital Requirement Regulation (CRR 2) sets public disclosures for interest rate risk in the banking book (*IRRBB*) for both quantitative and qualitative components, and entered into force on June 28<sup>th</sup> 2021.

Public disclosures on *IRRBB* were not covered by the *EBA ITS* endorsed by EU Commission on 19<sup>th</sup> March 2021.

It is useful to remind the other Capital Requirement Directive (CRD) requirements on *IRRBB*, as described below.

The Article 84 of the CRD tasks the European Banking Authority (EBA) with (underlines by us):

- submitting Regulatory Technical Standards (RTS) for approval to the European Commission on the definition of a *standardized methodology* for the *evaluation* (i.e. not for the management and mitigation) of non-trading interest rate risks affecting both economic value of equity and net interest income;
  - including a *simplified methodology* for small and non-complex institutions
- publishing Guidelines:
  - for non-trading book interest rate risks:
    - on the evaluation *by* an institution's internal system to identify, evaluate, manage and mitigate non-trading book interest rate risks;

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- on the identification, management and mitigation *by* institutions of the non-trading book interest rate risks;
- on the determination whether internal systems are *not satisfactory for the evaluation*;
- for non-trading credit spread risks:
  - on the assessment and monitoring *by* institutions

Within this framework:

- for non-trading interest rate risks:
  - a competent authority *may* require:
    - an institution to use the *standardized methodology* for the purpose of *evaluating risk* only (i.e. not for the management and mitigation), when the internal systems are deemed not satisfactory for the evaluation;
    - a small and non-complex institution to use the standardized methodology to capture risks
  - guidelines apply:
    - to institutions internal process for the risks' identification, evaluation, management and mitigation;
    - to competent authorities for the identification of situations whereby the internal system evaluation would be deemed not satisfactory.

Hence, the *standardized methodology*, within which the *simplified methodology*, refers to non-trading interest rate (i.e. not non-trading credit spread) and may be required to be applied for the evaluation of risks only to the extent that internal systems would be deemed not satisfactory for the evaluation.

However, institutions, respectively small and non-complex institutions, *may elect*, i.e. at *their* discretion, to use the *standardized methodology* (resp. *simplified methodology*) to identify, evaluate, manage and mitigate non-trading interest rate risks.

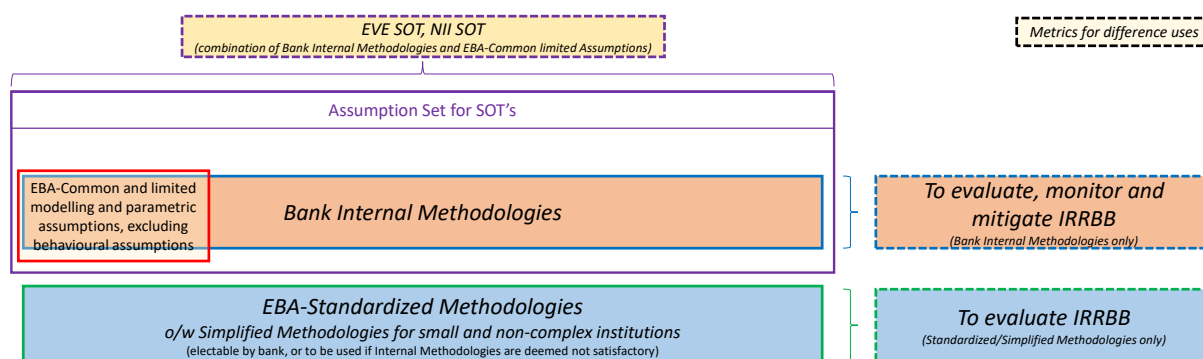
Besides, the Article 98(5a) of the CRD tasks the EBA with submitting a RTS for approval to the European Commission on the definitions of the below listed elements for the calculation of the two so-called Supervisory Outlier Test (SOT) (i.e. they don't apply to other metrics being calculated):

- the *six supervisory shock scenarios* for the evaluation of the changes in the Economic Value of Equity (EVE) SOT and the *two supervisory shock scenarios* for the evaluation of the changes in Net Interest Income (NII) SOT (*hence, the two supervisory shock scenarios for SOT NII are not necessarily two out of the six supervisory shock scenarios for SOT EVE as it would make very much sense to be adapted to the horizon over which SOT NII is considered*); and
- *'common modelling and parametric assumptions, excluding behavioural assumptions [...] which shall be limited to [...]'* for the calculation of the sensitivities of the *economic*

value of equity and the net interest income referred to in CRD Article 98(5) (i.e. the so-called Supervisory Outlier Tests, *SOT*'s).

Hence, Article 448 relates to those *SOT* metrics-only based on the to-be-defined common assumptions, i.e. not based on the *standardized or simplified methodologies*.

This can be represented as below:



As Article 448 Public Disclosures refer to *EVE SOT* and *EVE NII*, the communication is expected to be consistent with those *SOT* when they are expressed in relative terms, i.e. the *EVE SOT* would be communicated as a percentage of Tier One and the *NII SOT* would be communicated as a percentage of whatever will be defined in the final *RTS*.

## Comments on Consultation Paper on Public Disclosures for IRRBB:

**Question 1: Are the instructions, table and template clear to the respondents? If not, please provide concrete suggestions to improve them.**

Generally, the instructions, table and template are clear.

However, the table EU IRRBBA should make clear that, with regard to rows (g) and (h), considering the number of modelling and parametric assumptions for the management of IRRBB, as well as sensitivity of those assumptions, the descriptions are expected to be high level.

Regarding implementation of Article 448, those public disclosures are expected to be consistent with *SOT* metrics as they are defined, i.e. as a percentage of Tier One for *EVE* and as a percentage of whatever will be retained in the final *RTS*. This will help comparison to applicable thresholds (e.g. 15% for *SOT EVE*).

**Question 2: Do the respondents consider the development of these draft ITS based on the current underlying regulation as a sensible and practical approach, given the timing mismatch between the applicability of the disclosure requirements in accordance with Article 448 CRR and the finalization of the new regulatory framework for IRRBB?**

The proposed draft *ITS* on public disclosures on *IRRBB* are generally aligned with the Article 448 of *CRR 2*.

As Article 448 refers to components that are not yet defined, it could be argued that the conditions are not met to implement it.

However, as some components relate to the future Regulatory Technical Standards (RTS) for which the EBA is mandated by CRD Article 98(5a), notably with regard to the *six supervisory shocks* for EVE SOT and the *two supervisory shocks* for NII SOT, we welcome the pragmatic approach to leave discretion to banks to explain how they fill the gap.

For instance, while the *supervisory shock scenarios* are being defined, banks may use their own scenarios in the interim period notably for the two scenarios for NII that may be different from the *six supervisory shock scenarios* for EVE SOT. Hence, banks may elect a  $\pm 100$  basis points shock as appropriate for the first year NII sensitivities.

As another illustration, banks may use different horizons for NII.

As is well known, it is impossible to mitigate simultaneously both EVE and NII. Hence, in their interest rate risk management, banks elect the balance they are willing to strike between those two metrics. As EVE SOT and EVE NII would not be aligned with their own objectives, and may even deliver conflicting signals (e.g. increase in rates having a positive impact on NII while having a negative impact on EVE), those disclosures are expected to be accompanied with comments from banks to help financial statement users to make sense of them.

We take the opportunity to remind that:

- the mandate on Article 98(5a) relates to the *six supervisory interest rate shocks* for EVE SOT and the *two supervisory shocks* for NII SOT, the common modelling and parametric assumptions *excluding behavioural assumptions*;
- *CRR Article 448* refers to internal methodologies beyond the '*common modelling and parametric assumptions, excluding behavioural assumptions*' referred to in Article 98(5a) of Capital Regulation Directive (CRD 4);
- hence, the *standardized methodology*, as well as the *simplified methodology*, referred to Article 98(5a), do *not* apply to public disclosures *unless the bank has elected* to use them for their management (as per Article 85(5)).

**Question 3: Regarding template EU IRRBB1, do the respondents agree on disclosing the changes in the net interest income under the two supervisory shock scenarios of parallel up and down, in line with the Basel disclosure template, and on the interim solution proposed in the instructions to columns c, d of this template until the underlying regulatory framework on IRRBB is not yet finalized?**

Level 1 CRR 2 requires such disclosure, which hence cannot be agreed or disagreed with.

Formally, there is no interim solution as this consultation cannot be considered as binding until the final *ITS* is published.

Regarding the template EU IRRBB1, we would like to make the following comments:

- the period to which Net Interest Income relates should be clarified (e.g. forward looking one year rolling period, first three forward looking rolling period);
- the template should not be limitative of additional scenarios and / or assumptions different and / or NII horizons from the *EBA-defined common assumptions* that banks

may elect to consider as the *supervisory shock scenarios* may need being complemented with more reasonable changes that could occur.

## **Appendix 1: Capital Requirement Directive**

### **Article 84 – Interest Rate Risk from non-Trading Book Activities**

<https://eba.europa.eu/regulation-and-policy/single-rulebook/interactive-single-rulebook/101235>

1. Competent authorities shall ensure that institutions implement internal systems, use the standardised methodology **or** the simplified standardised methodology to identify, evaluate, manage and mitigate the risks arising from potential changes in interest rates that affect both the economic value of equity and the net interest income of an institution's non-trading book activities.

2. Competent authorities shall ensure that institutions implement systems to assess and monitor the risks arising from potential changes in credit spreads that affect both the economic value of equity and the net interest income of an institution's non-trading book activities.

3. A competent authority may require an institution to use the standardised methodology referred to in paragraph 1 where the internal systems implemented by that institution for the purpose of evaluating the risks referred to in that paragraph are not satisfactory.

4. A competent authority may require a small and non-complex institution as defined in point (145) of Article 4(1) of Regulation (EU) No 575/2013 to use the standardised methodology where it considers that the simplified standardised methodology is not adequate to capture interest rate risk arising from non-trading book activities of that institution.

5. EBA shall develop draft regulatory technical standards to specify, for the purposes of this Article, a standardised methodology that institutions may use for the purpose of evaluating the risks referred to in paragraph 1 of this Article, including a simplified standardised methodology for small and non-complex institutions as defined in point (145) of Article 4(1) of Regulation (EU) No 575/2013 which is at least as conservative as the standardised methodology.

EBA shall submit those draft regulatory technical standards to the Commission by 28 June 2020.

Power is delegated to the Commission to supplement this Directive by adopting the regulatory technical standards referred to in the first sub paragraph in accordance with Articles 10 to 14 of Regulation (EU) No 1093/2010.

6. EBA shall issue guidelines to specify the criteria for:

(a) the evaluation **by** an institution's internal system of the risks referred to in paragraph 1;

(b) the identification, management and mitigation **by** institutions of the risks referred to in paragraph 1;

(c) the assessment and monitoring **by** institutions of the risks referred to in paragraph 2;

(d) determining which of the internal systems implemented **by** institutions for the purposes of paragraph 1 are not satisfactory as referred to in paragraph 3.

EBA shall issue those guidelines by 28 June 2020.

### **Article 98(5) – Technical criteria for the supervisory review and evaluation Additional own funds requirement**

<https://eba.europa.eu/regulation-and-policy/single-rulebook/interactive-single-rulebook/101278>

5. The review and evaluation performed by competent authorities shall include the exposure of institutions to the interest rate risk arising from non-trading book activities.

The supervisory powers shall be exercised at least in the following cases:

(a) where an institution's economic value of equity as referred to in Article 84(1) declines by more than 15 % of its Tier 1 capital as a result of a sudden and unexpected change in interest rates as set out in any of the six supervisory shock scenarios applied to interest rates;

(b) where an institution's net interest income as referred to in Article 84(1) experiences a large decline as a result of a sudden and unexpected change in interest rates as set out in any of the two supervisory shock scenarios applied to interest rates.

Notwithstanding the second subparagraph, competent authorities shall not be obliged to exercise supervisory powers where they consider, based on the review and evaluation referred to in this paragraph, that the institution's management of interest rate risk arising from non-trading book activities is adequate and that the institution is not excessively exposed to interest rate risk arising from non-trading book activities.

For the purposes of this paragraph, the term 'supervisory powers' means the powers referred to in Article 104(1) or the power to specify modelling and parametric assumptions, other than those identified by EBA pursuant to point (b) of paragraph 5a of this Article, to be reflected by institutions in their calculation of the economic value of equity under Article 84(1).

5a. EBA shall develop draft regulatory technical standards to specify for the purposes of paragraph 5:

(a) the six supervisory shock scenarios as referred to in point (a) of the second subparagraph of paragraph 5 and the two supervisory shock scenarios as referred to in point (b) of the second subparagraph of paragraph 5 to be applied to interest rates for every currency;

(b) in light of internationally agreed prudential standards, the common modelling and parametric assumptions, excluding behavioural assumptions, that institutions shall reflect in their calculations of the economic value of equity as referred to in point (a) of the second subparagraph of paragraph 5, which shall be limited to:

(i) the treatment of the institution's own equity;

(ii) the inclusion, composition and discounting of cash flows sensitive to interest rates arising from the institution's assets, liabilities and off-balance-sheet items, including the treatment of commercial margins and other spread components;

(iii) the use of dynamic or static balance sheet models and the resulting treatment of amortised and maturing positions.

(c) in light of internationally agreed standards, the common modelling and parametric assumptions, excluding behavioural assumptions, that institutions shall reflect in their calculations of the net interest income as referred to in point (b) of the second subparagraph of paragraph 5 which shall be limited to:

(i) the inclusion and composition of cash flows sensitive to interest rates arising from the institution's assets, liabilities and off-balance-sheet items,



*including the treatment of commercial margins and other spread components;*

*(ii) the use of dynamic or static balance sheet models and the resulting treatment of amortised and maturing positions;*

*(iii) the period over which future net interest income shall be measured;*

*(d) what constitutes a large decline as referred to in point (b) of the second subparagraph of paragraph 5.*

*EBA shall submit those draft regulatory technical standards to the Commission by 28 June 2020.*

*Power is delegated to the Commission to supplement this Directive by adopting the regulatory technical standards referred to in the first sub paragraph in accordance with Articles 10 to 14 of Regulation (EU) No 1093/2010.*

### **Article 104 – Supervisory Powers**

<https://www.eba.europa.eu/regulation-and-policy/single-rulebook/interactive-single-rulebook/101291>

*1. For the purposes of Article 97, Article 98(4) and (5), Article 101(4) and Article 102 of this Directive and of the application of Regulation (EU) No 575/2013, competent authorities shall have at least the power to:*

*(a) require institutions to have additional own funds in excess of the requirements set out in Regulation (EU) No 575/2013, under the conditions set out in Article 104a of this Directive;*

*(b) require the reinforcement of the arrangements, processes, mechanisms and strategies implemented in accordance with Articles 73 and 74;*

*(c) require institutions to submit a plan to restore compliance with supervisory requirements pursuant to this Directive and to Regulation (EU) No 575/2013 and set a deadline for its implementation, including improvements to that plan regarding scope and deadline;*

*(d) require institutions to apply a specific provisioning policy or treatment of assets in terms of own funds requirements;*

*(e) restrict or limit the business, operations or network of institutions or to request the divestment of activities that pose excessive risks to the soundness of an institution;*

*(f) require the reduction of the risk inherent in the activities, products and systems of institutions, including outsourced activities;*

*(g) require institutions to limit variable remuneration as a percentage of net revenues where it is inconsistent with the maintenance of a sound capital base;*

*(h) require institutions to use net profits to strengthen own funds;*

*(i) restrict or prohibit distributions or interest payments by an institution to shareholders, members or holders of Additional Tier 1 instruments where the prohibition does not constitute an event of default of the institution;*

*(j) impose additional or more frequent reporting requirements, including reporting on own funds, liquidity and leverage;*



(k) impose specific liquidity requirements, including restrictions on maturity mismatches between assets and liabilities;

(l) require additional disclosures.

2. For the purposes of point (j) of paragraph 1, competent authorities may only impose additional or more frequent reporting requirements on institutions where the relevant requirement is appropriate and proportionate with regard to the purpose for which the information is required and the information requested is not duplicative.

For the purposes of Articles 97 to 102, any additional information that may be required from institutions shall be deemed as duplicative where the same or substantially the same information has already been otherwise reported to the competent authority or may be produced by the competent authority.

The competent authority shall not require an institution to report additional information where it has previously received it in a different format or level of granularity and that different format or granularity does not prevent the competent authority from producing information of the same quality and reliability as that produced on the basis of the additional information that would be otherwise reported.

#### **Article 104a – Additional own funds requirement**

<https://eba.europa.eu/regulation-and-policy/single-rulebook/interactive-single-rulebook/101295>

2. For the purposes of point (a) of paragraph 1 of this Article, risks or elements of risk shall only be considered as not covered or not sufficiently covered by the own funds requirements set out in Parts Three, Four and Seven of Regulation (EU) No 575/2013 and in Chapter 2 of Regulation (EU) 2017/2402 where the amounts, types and distribution of capital considered adequate by the competent authority, taking into account the supervisory review of the assessment carried out by institutions in accordance with the first paragraph of Article 73 of this Directive, are higher than the own funds requirements set out in Parts Three, Four and Seven of Regulation (EU) No 575/2013 and in Chapter 2 of Regulation (EU) 2017/2402.

For the purposes of the first subparagraph, competent authorities shall assess, taking into account the risk profile of each individual institution, the risks to which the institution is exposed, including:

(a) institution-specific risks or elements of such risks that are explicitly excluded from or not explicitly addressed by the own funds requirements set out in Parts Three, Four and Seven of Regulation (EU) No 575/2013 and in Chapter 2 of Regulation (EU) 2017/2402;

(b) institution-specific risks or elements of such risks likely to be under estimated despite compliance with the applicable requirements set out in Parts Three, Four and Seven of Regulation (EU) No 575/2013 and in Chapter 2 of Regulation (EU) 2017/2402.

To the extent that risks or elements of risk are subject to transitional arrangements or grandfathering provisions laid down in this Directive or in Regulation (EU) No 575/2013, they shall not be considered risks or elements of such risks likely to be underestimated despite compliance with the applicable requirements set out in Parts Three, Four and Seven of Regulation (EU) No 575/2013 and in Chapter 2 of Regulation (EU) 2017/2402.

For the purposes of the first subparagraph, the capital considered adequate shall cover all risks or elements of risks identified as material pursuant to the assessment laid down in the second subparagraph of this paragraph that are not covered or not sufficiently covered

by the own funds requirements set out in Parts Three, Four and Seven of Regulation (EU) No 575/2013 and in Chapter 2 of Regulation (EU) 2017/2402.

Interest rate risk arising from non-trading book positions may be considered material at least in the cases referred to in Article 98(5), unless the competent authorities, in performing the review and evaluation, come to the conclusion that the institution's management of interest rate risk arising from non-trading book activities is adequate and that the institution is not excessively exposed to interest rate risk arising from non-trading book activities.

[...]

## **Appendix 2: Capital Requirement Regulation**

### **Article 448 Disclosure of exposures to interest rate risk on positions not held in the trading book**

1. As from 28 June 2021, institutions shall disclose the following quantitative and qualitative information on the risks arising from potential changes in interest rates that affect both the economic value of equity and the net interest income of their non-trading book activities referred to in Article 84 and Article 98(5) of Directive 2013/36/EU:

- a) the changes in the economic value of equity calculated under the six supervisory shock scenarios referred to in Article 98(5) of Directive 2013/36/EU for the current and previous disclosure periods;
- b) the changes in the net interest income calculated under the two supervisory shock scenarios referred to in Article 98(5) of Directive 2013/36/EU for the current and previous disclosure periods;
- c) a description of key modelling and parametric assumptions, other than those referred to in points (b) and (c) of Article 98(5a) of Directive 2013/36/EU used to calculate changes in the economic value of equity and in the net interest income required under points (a) and (b) of this paragraph;
- d) an explanation of the significance of the risk measures disclosed under points (a) and (b) of this paragraph and of any significant variations of those risk measures since the previous disclosure reference date;
- e) the description of how institutions define, measure, mitigate and control the interest rate risk of their non-trading book activities for the purposes of the competent authorities' review in accordance with Article 84 of Directive 2013/36/EU, including:
  - i. a description of the specific risk measures that the institutions use to evaluate changes in their economic value of equity and in their net interest income;
  - ii. a description of the key modelling and parametric assumptions used in the institutions' internal measurement systems that would differ from the common modelling and parametric assumptions referred to in Article 98(5a) of Directive 2013/36/EU for the purpose of

- calculating changes to the economic value of equity and to the net interest income, including the rationale for those differences;*
- iii. a description of the interest rate shock scenarios that institutions use to estimate the interest rate risk;*
  - iv. the recognition of the effect of hedges against those interest rate risks, including internal hedges that meet the requirements laid down in Article 106(3);*
  - v. an outline of how often the evaluation of the interest rate risk occurs;*
- f) the description of the overall risk management and mitigation strategies for those risks;*
- g) average and longest repricing maturity assigned to non-maturity deposits.*

*2. By way of derogation from paragraph 1 of this Article, the requirements set out in points (c) and (e)(i) to (e) (iv) of paragraph 1 of this Article shall not apply to institutions that use the standardised methodology or the simplified standardised methodology referred to in Article 84(1) of Directive 2013/36/EU.*

## About EBF

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