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**EBF Responses to the Three Consultation Papers published by the European Banking Authority (EBA) on the Interest Rate Risk in the Banking Book (IRRBB) and Credit Spread Risk in the Banking Book (CSRBB)**

Published 2 December 2021 with Consultation End 4 April 2022

***Context***

Articles 84 and 98 of Capital Requirement Directive (*CRD*) task the European Banking Authority (*EBA*) to elaborate Guidelines and two Regulatory Technical Standards (*RTS*) for which *EBA* has published Consultation Papers (*CP*) on 2nd December 2021 with end of consultation set on 4th April 2022:

1. *Draft Guidelines issued on the basis of Article 84 (6) of Directive 2013/36/EU specifying aspects of the Identification, Evaluation, Management and Mitigation of the Risks Arising from Potential Changes in Interest Rates and of the Assessment and Monitoring of Credit Spread risk, of Institutions’ non-Trading Book Activities,* [*CP Draft GL on IRRBB and CSRBB.pdf (europa.eu)*](https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/Consultations/2022/Consultation%20on%20draft%20Guidelines%20on%20IRRB%20and%20CSRBB/1025042/CP%20Draft%20GL%20on%20IRRBB%20and%20CSRBB.pdf)*;*
2. *Draft Regulatory Technical Standards (RTS) specifying Supervisory Shock Scenarios, Common Modelling and Parametric Assumptions and What Constitutes a Large Decline for the Calculation of the Economic Value of Equity and of the Net Interest Income in accordance with 98(5a) of Directive 2013/36/EU,* [*CP Draft RTS on SOTs.pdf (europa.eu)*](https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/Consultations/2022/Consultation%20on%20draft%20RTS%20on%20IRRB%20supervisory%20outlier%20tests/1025043/CP%20Draft%20RTS%20on%20SOTs.pdf)*;*
3. *Draft Regulatory Technical Standards specifying standardised and simplified standardised methodologies to evaluate 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 in accordance with 84(5) of Directive 2013/36/EU,* [*CP Draft RTS on SA.pdf (europa.eu)*](https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/Consultations/2022/Consultation%20on%20draft%20RTS%20on%20IRRBB%20standardised%20approach/1025041/CP%20Draft%20RTS%20on%20SA.pdf)*.*

Please find below our main comments and recommendations on each of these three *CP*’s, which are complemented with responses to CP’s questions in appendices.

1. **Consultation Paper EBA/CP/2021/37 on Management Framework for Interest Rate Risk in the Banking Book and Credit Spread Risk in the Banking Book**

Article 84(6) of Capital Requirement Directive (*CRD*) tasks the European Banking Authority (*EBA)* with developing a Guideline to define:

* the evaluation by an institution's internal system;
* the identification, management and mitigation by institutions of the risks;
* the assessment and monitoring by institutions of the risks;
* determining which of the internal systems are not satisfactory.

*The European Banking Authority (EBA*) has published *Guidelines on Interest Rate Risk in the Banking Book (IRRBB*) in May 2015 and July 2018, and is to publish yet another version of its *Guideline* on the very same topic in the course of 2022. There is a need to a stable regulatory framework and we are hopeful that it will be stabilized.

In July 2018, *EBA* elected to modify its *May 2015 Guideline* to factor in Basel Committee on Banking Supervision (*BCBS) Standard* on *IRRBB* published in April 2016 ahead of the mandate to be received from *CRR* to factor in this very same *BCBS Standard*. Hence, the *EBA 2018 Guideline* should be only marginally modified and modifications should be limited to areas of 2016 BCBS standard that were not covered in *EBA 2018 Guidelines*.

However, the Consultation Paper (*CP*) introduces **very significant deviations** from *July 2018 Guideline* that are not substantiated by any change in *BCBS* or *CRD* mandate and actually can be considered as:

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

**NII should be kept as defined by interest income and expenses.**

* **The *CP* envisages a new limitation to the duration of Non-Maturing Deposits (*NMD’s*)** (i.e. a 5 year cap on NMD’s from retail and non-financial wholesale, and a 0 year cap on *NMD’s* from financial customers) following a said “prudent” approach. These caps are inconsistent with a prudent approach since interest rate risk is a symmetric risk. Without any economic justification, they would lead to inappropriate measurement and management if incorporated in a management framework. Such caps are neither in CRR / CRD nor in *BCBS Standard* (where such caps appear only in the non-mandatory standardized method).

Such caps would not only be at odds with evidence for some *NMD*’s but would jeopardize the business models whereby the *NMD*’s are a natural offset of long-term fixed rate loans (e.g. fixed rate mortgages). This would lead to wrong interest rate risk mitigation transactions, expose banks to more interest rate risk and force a change in business models by modifying the capacity to offer long-term loans to customers.

Furthermore, the mandate to the *EBA* on the definition of *SOT* explicitly *excludes* behavioural assumptions (*CRD* Art.98(5a): ‘*common modelling and parametric assumptions, excluding behavioural assumptions*). The suggested introduction of caps on *NMD’s* in the general framework of *IRRBB* management appears as *EBA* working around the mandates that it received.

**Suggested caps on *NMD*’s should be deleted**.

* **the *CP* envisages dramatic changes to the definition and scope of Credit Spread Risk in the Banking Book (*CSRBB*)** while the *July 2018 EBA Guideline* already implemented the *BCBS Standard* that has not changed since then. The envisaged changes are not substantiated and they would also introduce significant confusions and complexities.

***CSRBB* should relate to fair-valued assets that are actively traded on a deep and liquid markets so as to have identifiable and measurable market perception and changes thereof. Derivatives, if any, that are hedging *CSRBB* should be clarified as included in *CSRBB*. Pension obligations and pension plan assets should be clarified as being excluded from *CSRBB*.**

We also noted that the *EBA* by means of article 14 has expanded the scope of article 84.6c for *CSRBB*, where institutions are only obliged to assess and monitor credit spread risk. Article 14 of this *Guideline* would also oblige institutions to control credit spread risk. However, in article 84 the *CRD* explicitly differentiates between *IRRBB* and *CSRBB*, where the management and mitigation is limited to *IRRBB*. Therefore, asking institutions to control credit spread is beyond the mandate of the *EBA* and not deemed proportionate.

* the *CP* provides principles for the assessment by competent authorities of the management framework for *IRRBB* and *CSRBB*. Broadly, those principles make sense to cover the different dimensions of the management framework. However, to the extent that the assessment could lead competent authorities to require banks to apply the *Standardized Methodology* for the evaluation of *IRRBB*, it is essential to better frame the conditions under which banks such a requirement could apply.

**The requirement to apply the *Standardized Methodology* for the evaluation should relate to the evaluation component of the Internal Management System (*IMS*) that should be evidenced as non-satisfactory**. In other words, a framework that would be assessed as non-satisfactory for issues that are *not* related to its evaluation component of its *IMS* should *not* lead to require using the *Standardized Methodology*.

As any *Standardized Methodology* would not be risk sensitive, as made clear by *BCBS*, **it should be clarified that requiring its application should follow a careful analysis to evidence whether the *Standardized Methodology* would be more risk sensitive than the *IMS* evaluation it would substitute. Bar such an evidence, *Standardized Methodology* should *not* apply. Moreover, the GL should require competent authorities to grant institutions the possibility to remedy potential shortcomings in their *IMS* within a reasonable period of time before the *Standardized Methodology* is imposed. Last but not least, if the *Standardized Methodology* was imposed after all, this should only be temporary and a return to IMS should be allowed as soon as possible.**

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

**Please find in appendix the responses to *CP* questions.**

1. **Consultation Paper EBA/CP/2021/36 on Supervisory Outlier Tests**

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

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

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

* **the *CP* envisages to change the definition of commonly understood Net Interest Income (*NII*) to include changes in fair values of instruments** even though they are not part of *NII*. This appears as a deviation from the *CRR* mandate that explicitly refers to *NII*. It also deviates from Basel Committee on Banking Supervision*(BCBS) Standard* that is quite explicit that it refers to *NII* excluding changes in fair values that do not affect *NII*. This would also be at odds with actual risk management and would introduce overlapping between *NII* measures and Economic Value (*EV*) measures, such as *SOT EVE* and *SOT NII*, while they should be complementary.

**NII should be kept as defined by interest income and expenses.**

* to be aligned with the *CRD* mandate, **the draft *RTS* should explicitly mention that the common modelling and parametric assumptions *exclude* behavioural assumptions and should apply only to the calculation of *SOT*’s**.

The behavioral assumptions should align the with internal management system (*IMS*) behavioural assumptions without limitations (e.g. no caps on NMD’s) so that the interest rate risk is adequately measured. It is essential to avoid uneconomic interest rate risk measurement and management that would be driven to satisfy either one or the two *SOT*.

* the *CP* envisages to apply two supervisory parallel shock scenarios for *SOT NII* that apply instantaneously with magnitudes that are not consistent with facts. In developed countries, Central Banks carefully modify their interest rates over time with managing market expectations to avoid triggering market surprises. Hence, their expected changes are factored in the interest rate curve well *before* the changes actually occur. As shocks apply *on top of* those expected changes, the shocks should be adapted.

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

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

* The *CP* that *SOT NII* is suggested to be calculated with a constant balance sheet.

**It should be clarified that within this constant balance sheet requirement, Internal Management System (*IMS*) assumptions, such as behavioural assumptions, apply.**

To the extent that a dynamic balance approach would be used in *IMS*, notably when the dynamic balance sheet enables to capture behavioural assumptions that excluded from the scope of common parametric assumptions, we believe that **a discretion should be provided for the bank and the competent authority to use dynamic balance sheet for *SOT NII***. As public disclosures requirements are based on *SOT NII* assumptions (which is a deviation from *BCBS Standard*), such a discretion would enable consistency with actual management.

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

**Further analyses should be developed over time before electing a specific ratio and its accompanying large decline thresholds.**

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

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

* **no automatic supervisory measures should apply in case of crossing *SOT*’s thresholds. There should be no direct link between the *SOT*’s and the identification of internal capital that may be identified for *IRRBB*.**
* **no full integration of *SOT*s into the internal measurement and/ or management should be required.**
* **no (Pillar 3) disclosure obligation should be applied.**
* **Upon final publication in the *Official Journal of the European Union*, the *RTS* should, in any case, enter into force no sooner than the end of the next calendar semester after publication date** so as to enable banks to adapt. Ideally, the date of application should be aligned with the Guideline and the *RTS* on *Standardized Methodologies*.

1. **Consultation Paper EBA/CP/2021/38 on Standardized Methodology**

Article 84(5) of Capital Requirement Directive (*CRD*) tasks the European Banking Authority (*EBA*) with developing Regulatory Technical Standards (*RTS*) to define a standardised methodology that institutions may use for the purpose of evaluating the [interest rate] risks […], including a simplified standardised methodology for small and non-complex institutions.

It is worth reminding that the Basel Committee on Banking Supervision (*BCBS*) has clearly mentioned that IRRBB is not amenable to standardization as any standardized measure of IRRBB would lose its risk-sensitivity and would fail to be relevant for supervisory measures:

*§3. The Committee noted the industry’s feedback on the feasibility of a Pillar 1 approach to IRRBB, in particular* ***the complexities involved in formulating a standardised measure of IRRBB which would be both sufficiently accurate and risk-sensitive to allow it to act as a means of setting regulatory capital requirements****. The Committee concludes that the heterogeneous nature of IRRBB would be more appropriately captured in Pillar 2.*

In that context, **a *Standardized* (or *Simplified*) *Methodology* would definitely not be risk sensitive.**

It is noted that there is no provided evidence to support adequacy of the suggested standardized / simplified factors.

*Standardised Methodologies* can be useful to ensure the proportionality of the framework and provide an acceptable estimate of risk in case of banks of low size and/or complexity. However, they necessarily rely on simplistic assumptions which make them by definition less accurate than internal models (but not more conservative). The more complex the bank, the more sophisticated models are needed to manage and measure interest rate risk.

Therefore, we have very strong concerns that Standardised Methodologies could have to be mandatorily applied to a bank. As Article 98(3-4) refers to the standardized and simplified methodologies that the competent authority could impose for the *evaluation* of risks, **we recommend that the *RTS* clarifies that such an imposition should be**:

* **limited to the evaluation** (which will be necessarily wrong as mentioned before) **and not for the actual management** (as banks would have to manage with flawed steering metrics that would be detrimental to the actual risk management) as clearly mentioned in Art.98(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.*”;
* **conditional on competent authority having demonstrated that the *standardized* (resp. *simplified*) *methodology* would be more relevant than the *IMS*-evaluation that it would pretend substituting.**

And **we recommend that, as specified in the *CRD*, it is made clear that the *standardized* (*simplified*) *methodology* does not have to be implemented, unless imposed or elected by the bank, and should not be used as a benchmark for *IMS*.**

As regards the proposed approaches, certain aspects should be addressed.

As an example, the suggested caps on Non Maturing Deposits (*NMDs*) may significantly distort the economic representation of interest rate risk.

As another illustration, it is not appropriate to use a stress volatility when measuring the sensitivity of automatic options in the objective of hedging them. With such an approach, one would be led to un-appropriate delta hedge of the options since the measurement would be distorted. It is highlighted that such a stress on volatility is neither performed in trading book nor required by the regulators for trading books regulations. By the way, requiring this to be applied for the Supervisory Outlier Test (*SOT*) on Economic Value of Equity (*EVE*) is inconsistent with the objective of the *SOT EVE* which is to measure the sensitivity to changes in interest rates.

**The *CP* envisages changing the definition of commonly understood Net Interest Income (*NII*) to include changes in fair values of instruments** even though they are not part of *NII*. This appears as a deviation from the *CRR* mandate that explicitly refers to *NII*. It also deviates from Basel Committee on Banking Supervision*(BCBS) Standard* that is quite explicit that it refers to *NII* excluding changes in fair values that do not affect *NII*. This would also be at odds with actual risk management and would introduce overlapping between *NII* measures and Economic Value (*EV*) measures, such as *SOT EVE* and *SOT NII*, while they should be complementary.

**NII should be kept as defined by interest income and expenses.**

Last but not least, the final application date should be aligned with the *Guideline* and the *RTS* on *Supervisory Outlier Tests*.

**European Banking Authority (EBA) Consultation Paper (CP) on the Identification, Evaluation, Management and Mitigation of Risks Arising from Potential Changes in Interest Rates and of the Assessment and Monitoring of Credit Spread risk, of Institutions’ non-Trading Book Activities**

(Published 2 December 2021 with Consultation End 4 April 2022)

*Link to Consultation Paper:* [*CP Draft GL on IRRBB and CSRBB.pdf (europa.eu)*](https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/Consultations/2022/Consultation%20on%20draft%20Guidelines%20on%20IRRB%20and%20CSRBB/1025042/CP%20Draft%20GL%20on%20IRRBB%20and%20CSRBB.pdf)

***Question 1: In the context of the measurement of the impact of IRRBB under internal systems, paragraph 111 envisages a five-year cap repricing maturity for retail and non-financial wholesale deposits without a specified maturity. Would you foresee any unintended consequence or undesirable effect from this behavioural assumption in particular on certain business models or specific activities? If this is the case, please kindly provide concrete examples of it.***

***Response:***

* **The *CP* envisages a new limitation to the duration of Non Maturing Deposits (*NMD’s*)** (i.e. a 5 year cap on NMD’s from retail and non-financial wholesale, and a 0 year cap on *NMD’s* from financial customers) following a said “prudent” approach. These caps are inconsistent with a prudent approach since interest rate risk is a symmetric risk. Without any economic justification, they would lead to inappropriate measurement and management if incorporated in a management framework. Such caps are neither in CRR / CRD nor in *BCBS Standard* (where such caps appear only in the non-mandatory standardized method).

Such caps would not only be at odds with evidence for some *NMD*’s but would jeopardize the business models whereby the *NMD*’s are a natural offset of long-term fixed rate loans (e.g. fixed rate mortgages). This would lead to wrong interest rate risk mitigation transactions, expose banks to more interest rate risk and force a change in business models by modifying the capacity to offer long-term loans to customers.

Furthermore, the mandate to the *EBA* on the definition of *SOT* explicitly *excludes* behavioural assumptions (*CRD* Art.98(5a): ‘*common modelling and parametric assumptions, excluding behavioural assumptions*). The suggested introduction of caps on *NMD’s* in the general framework of *IRRBB* management appears as *EBA* working around the mandates that it received.

**Suggested caps on *NMD*’s should be deleted**.

***Question 2: Do respondents find that the criteria to identify non-satisfactory IRRBB internal models provide the minimum elements for supervisors’ assessment?***

***Response:***

* the *CP* provides principles for the assessment by competent authorities of the management framework for *IRRBB* and *CSRBB*. Broadly, those principles make sense to cover the different dimensions of the management framework. However, to the extent that the assessment could lead competent authorities to require banks to apply the *Standardized Methodology* for the evaluation of *IRRBB*, it is essential to better frame the conditions under which banks such a requirement could apply.

**The requirement to apply the *Standardized Methodology* for the evaluation should relate to the evaluation component of the Internal Management System (*IMS*) that should be evidenced as non-satisfactory**. In other words, a framework that would be assessed as non-satisfactory for issues that are *not* related to its evaluation component of its *IMS* should *not* lead to require using the *Standardized Methodology*.

As any *Standardized Methodology* would not be risk sensitive, as made clear by *BCBS*, **it should be clarified that requiring its application should follow a careful analysis to evidence whether the *Standardized Methodology* would be more risk sensitive than the *IMS* evaluation it would substitute. Bar such an evidence, *Standardized Methodology* should *not* apply. Moreover, the GL should require competent authorities to grant institutions the possibility to remedy potential shortcomings in their IMS within a reasonable period of time before the Standardized Methodology is imposed. Last but not least, if the Standardized Methodology was imposed after all, this should only be temporary and a return to IMS should be allowed as soon as possible.**

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

**NII should be kept as defined by interest income and expenses.**

***Question 3: Is there any specific element in the definition of CSRBB that is not clear enough for the required assessment and monitoring of CSRBB by institutions?***

***Response:***

* **the *CP* envisages dramatic changes to the definition and scope of Credit Spread Risk in the Banking Book (*CSRBB*)** while the *July 2018 EBA Guideline* already implemented the *BCBS Standard* that has not changed since then. The envisaged changes are not substantiated and they would also introduce significant confusions and complexities.

***CSRBB* should relate to fair-valued assets that are actively traded on a deep and liquid markets so as to have identifiable and measurable market perception and changes thereof. Derivatives, if any, that are hedging *CSRBB* should be clarified as included in *CSRBB*. Pension obligations and pension plan assets should be clarified as being excluded from *CSRBB*.**

We also noted that the *EBA* by means of article 14 has expanded the scope of article 84.6c for *CSRBB*, where institutions are only obliged to assess and monitor credit spread risk. Article 14 of this CP would also oblige institutions to control credit spread risk. However, in article 84 the *CRD* explicitly differentiates between *IRRBB* and *CSRBB*, where the management and mitigation is limited to *IRRBB*. Therefore, asking institutions to control credit spread is beyond the mandate of the *EBA* and not deemed proportionate.

***Question 4: As to the suggested perimeter of items exposed to CSRBB, would you consider any specific conceptual or operational challenge to implement it?***

***Response:***

* **the *CP* envisages dramatic changes to the definition and scope of Credit Spread Risk in the Banking Book (*CSRBB*)** while the *July 2018 EBA Guideline* already implemented the *BCBS Standard* that has not changed since then. The envisaged changes are not substantiated and they would also introduce significant confusions and complexities.

***CSRBB* should relate to fair-valued assets that are actively traded on a deep and liquid markets so as to have identifiable and measurable market perception and changes thereof. Derivatives, if any, that are hedging *CSRBB* should be clarified as included in *CSRBB*. Pension obligations and pension plan assets should be clarified as being excluded from *CSRBB*.**

We also noted that the *EBA* by means of article 14 has expanded the scope of article 84.6c for *CSRBB*, where institutions are only obliged to assess and monitor credit spread risk. Article 14 of this CP would also oblige institutions to control credit spread risk. However, in article 84 the *CRD* explicitly differentiates between *IRRBB* and *CSRBB*, where the management and mitigation is limited to *IRRBB*. Therefore, asking institutions to control credit spread is beyond the mandate of the *EBA* and not deemed proportionate.

***Question 5: Is the separation of IRRBB and CSRBB sufficient to understand where the Guidelines apply to:***

* ***IRRBB only***
* ***CSRBB only***
* ***Both IRRBB and CSRBB?***

***Response:***

We repeat our remark on the differentiating made in article 94.6 of *CRD5*, where the *EBA* shall issue *Guideline* to identify, manage and mitigate *IRRBB* and only to assess and monitor *CSRBB*. Articles 126 and 127 are clearly outside the mandate of the *EBA* as this refers to managing and mitigating *CSRBB*.

**European Banking Authority (EBA) Consultation Paper (CP) on the Supervisory Shock Scenarios, Common Modelling and Parametric Assumptions and What Constitutes a Large Decline for the Calculation of the Economic Value of Equity and of the Net Interest Income**

Published 2 December 2021 with Consultation End 4 April 2022

*Link to Consultation Paper:* [*CP Draft RTS on SOTs.pdf (europa.eu)*](https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/Consultations/2022/Consultation%20on%20draft%20RTS%20on%20IRRB%20supervisory%20outlier%20tests/1025043/CP%20Draft%20RTS%20on%20SOTs.pdf)

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

***Response:***

* to be aligned with the *CRD* mandate, **the draft *RTS* should explicitly mention that the common modelling and parametric assumptions *exclude* behavioural assumptions and should apply only to the calculation of *SOT*’s**.

The behavioral assumptions should align the with internal management system (*IMS*) behavioural assumptions without limitations (e.g. no caps on NMD’s) so that the interest rate risk is adequately measured. It is essential to avoid uneconomic interest rate risk measurement and management that would be driven to satisfy either one or the two *SOT*.

* the *CP* envisages to apply two supervisory parallel shock scenarios for *SOT NII* that apply instantaneously with magnitudes that are not consistent with facts. In developed countries, Central Banks carefully modify their interest rates over time with managing market expectations to avoid triggering market surprises. Hence, their expected changes are factored in the interest rate curve well *before* the changes actually occur. As shocks apply *on top of* those expected changes, the shocks should be adapted.

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

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

* As regards the proposed recalibration of the lower bound, to be applied to post-shock interest rate levels, we do not see the need for such change. For the SOT on NII this lower bound is mainly determined by policies of the central banks. Nowadays this is large consensus that setting a policy rate below -/- 100 bps is ineffective. Therefore, the recalibrated lower bound seems rather unrealistic. Thus, **we do not support the proposed change in the lower bound. Should nonetheless the lower bound be changed, this should be factored in the calibration of the threshold.**

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

***Response:***

* **the *CP* envisages to change the definition of commonly understood Net Interest Income (*NII*) to include changes in fair values of instruments** even though they are not part of *NII*. This appears as a deviation from the *CRR* mandate that explicitly refers to *NII*. It also deviates from Basel Committee on Banking Supervision*(BCBS) Standard* that is quite explicit that it refers to *NII* excluding changes in fair values that do not affect *NII*. This would also be at odds with actual risk management and would introduce overlapping between *NII* measures and Economic Value (*EV*) measures, such as *SOT EVE* and *SOT NII*, while they should be complementary.

**NII should be kept as defined by interest income and expenses.**

* The *CP* that *SOT NII* is suggested to be calculated with a constant balance sheet.

**It should be clarified that within this constant balance sheet requirement, Internal Management System (*IMS*) assumptions, such as behavioural assumptions, apply.**

To the extent that a dynamic balance approach would be used in *IMS*, notably when the dynamic balance sheet enables to capture behavioural assumptions that excluded from the scope of common parametric assumptions, we believe that **a discretion should be provided for the bank and the competent authority to use dynamic balance sheet for *SOT NII***. As public disclosures requirements are based on *SOT NII* assumptions (which is a deviation from *BCBS Standard*), such a discretion would enable consistency with actual management.

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

**Further analyses should be developed over time before electing a specific ratio and its accompanying large decline thresholds.**

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

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

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

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

***Response:***

* **Upon final publication in the *Official Journal of the European Union*, the *RTS* should, in any case, enter into force no sooner than the end of the next calendar semester after publication date** so as to enable banks to adapt. Ideally, the date of application should be aligned with the GL and the RTS on Standardized Methodologies.

**European Banking Authority (EBA) Consultation Paper (CP) on the Draft Regulatory Technical Standards specifying standardised and simplified standardised methodologies to evaluate 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 in accordance with 84(5) of Directive 2013/36/EU**

Published 2 December 2021 with Consultation End 4 April 2022

*Link to Consultation Paper:* [*CP Draft RTS on SA.pdf (europa.eu)*](https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/Consultations/2022/Consultation%20on%20draft%20RTS%20on%20IRRBB%20standardised%20approach/1025041/CP%20Draft%20RTS%20on%20SA.pdf)

***Question 1: What is the materiality of prepayments for floating rate instruments and what are the underlying factors? Would you prefer the inclusion of a requirement in Article 6 for institutions to estimate prepayments for these instruments?***

***Response:***

n/a

***Question 2: Do respondents find that the required determination of stable / non-stable deposits, and core/non-core deposits as described in Article 7 is reflective of the risks and operationally implementable? In case of any unintended consequence or undesirable effect on certain business models or specific activities, please kindly provide concrete examples.***

***Response:***

n/a

***Question 3: Do respondents find that the required determination and application of a conditional prepayment rate and term deposit redemption rate as described in Article 8 and 9 is reflective of the risks and operationally implementable? In case of any unintended consequence or undesirable effect on certain business models or specific activities, please kindly provide concrete examples.***

***Response:***

n/a

***Question 4: Is the treatment of fixed rate loan commitments to retail counterparties clear and are there other instruments with retail counterparties where a behavioural approach to optionality should be taken?***

***Response:***

n/a

***Question 5: Do respondents find that the required determination of the impact of a 25% increase in implicit volatility as described in Article 12 is operationally implementable?***

***Response:***

n/a

***Question 6: Do respondents find that the required slotting of repricing cash flows in accordance with the second dimension of original maturity/reference term as described in Article 13 is operationally implementable?***

***Response:***

n/a

***Question 7: Do respondents find it practical how the determination of several components of the NII calculation, with in particular the fair value component of Article 20 and the fair value component of automatic options of Article 15, is generally based on the processes used for the EVE calculation (in particular Article 16 and Article 12)?***

***Response:***

It is worth reminding that the Basel Committee on Banking Supervision (*BCBS*) has clearly mentioned that IRRBB is not amenable to standardization as any standardized measure of IRRBB would lose its risk-sensitivity and would fail to be relevant for supervisory measures:

*§3. The Committee noted the industry’s feedback on the feasibility of a Pillar 1 approach to IRRBB, in particular* ***the complexities involved in formulating a standardised measure of IRRBB which would be both sufficiently accurate and risk-sensitive to allow it to act as a means of setting regulatory capital requirements****. The Committee concludes that the heterogeneous nature of IRRBB would be more appropriately captured in Pillar 2.*

In that context, **a *Standardized* (or *Simplified*) *Methodology* is definitely not risk sensitive.**

It is noted that there is no provided evidence to support adequacy of the suggested standardized / simplified factors.

Standardised methodologies can be useful to ensure the proportionality of the framework and provide an acceptable estimate of risk in case of banks of low size and/or complexity. However, they necessarily rely on simplistic assumptions which make them by definition less accurate than internal models (but not more conservative). The more complex the bank, the more sophisticated models are needed to manage and measure interest rate risk.

Therefore, we have very strong concerns that standardised methodologies could have to be mandatorily applied to a bank. As Article 98(3-4) refers to the standardized and simplified methodologies that the competent authority could impose for the *evaluation* of risks, **we recommend that the *RTS* clarifies that such an imposition should be**:

* **limited to the evaluation** (which will be necessarily wrong as mentioned before) **and not for the actual management** (as banks would have to manage with flawed steering metrics that would be detrimental to the actual risk management) as clearly mentioned in Art.98(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.*”;
* **conditional on competent authority having demonstrated that the *standardized* (resp. *simplified*) *methodology* would be more relevant than the *IMS*-evaluation that it would pretend substituting.**

And **we recommend that, as specified in the Directive, it is made clear that the *standardized* (*simplified*) *methodology* does not have to be implemented, unless imposed or elected by the bank, and should not be used as a benchmark for *IMS*.**

As regards the proposed approaches, certain aspects should be addressed.

As an example, the suggested caps on Non Maturing Deposits (*NMDs*) may significantly distort the economic representation of interest rate risk.

As another illustration, it is not appropriate to use a stress volatility when measuring the sensitivity of automatic options in the objective of hedging them. With such an approach, one would be led to un-appropriate delta hedge of the options since the measurement would be distorted. It is highlighted that such a stress on volatility is neither performed in trading book nor required by the regulators for trading books regulations. By the way, requiring this to be applied for the Supervisory Outlier Test (*SOT*) on Economic Value of Equity (*EVE*) is inconsistent with the objective of the *SOT EVE* which is to measure the sensitivity to changes in interest rates.

**The *CP* envisages changing the definition of commonly understood Net Interest Income (*NII*) to include changes in fair values of instruments** even though they are not part of *NII*. This appears as a deviation from the *CRR* mandate that explicitly refers to *NII*. It also deviates from Basel Committee on Banking Supervision*(BCBS) Standard* that is quite explicit that it refers to *NII* excluding changes in fair values that do not affect *NII*. This would also be at odds with actual risk management and would introduce overlapping between *NII* measures and Economic Value (*EV*) measures, such as *SOT EVE* and *SOT NII*, while they should be complementary.

**NII should be kept as defined by interest income and expenses.**

Last but not least, the final application date should be aligned with the *Guideline* and the *RTS* on *Supervisory Outlier Tests*.

***Question 8: Do respondents find that the calculation of the net interest income add-on for basis risk is reflective of the risk and operationally implementable?***

***Response:***

n/a

***Question 9: Do respondents find that the adjustments in the Simplified Standardised Approach as set out in Article 23 and 24 are operationally implementable and do they find that any other simplification would be appropriate?***

***Response:***

n/a

***Question 10: Do respondents find that all the necessary aspects are covered and the steps and assumptions for the evaluation of EVE and NII as laid out in the standardised approach and simplified standardised approach clear enough and operationally implementable?***

***Response:***

The final application date should be aligned with the Guideline and the *RTS* on *Supervisory Outlier Tests*.