POSITION PAPER

ESBG response to the EBA consultation on the draft RTS on IRRBB standardised approach

ESBG (European Savings and Retail Banking Group)

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ESBG

Dear Sir/Madam,

Thank you for the opportunity to comment on the European Banking Authority (EBA) consultation on the draft RTS on the IRRBB standardised approach. We would like to share the following reflections with you that we hope will be considered by the EBA.

General comments – Proportionality:

The EU framework for management of interest rate risk in the banking book has become very comprehensive and complex. Despite the legal basis for these documents being only two articles in the CRD (art 84 (5) and (6) and art 98 (5a)), the EBA is currently consulting on a total of 176 pages combined. In addition to this are the EBAs SREP guidelines, as well as guidelines and supervisory expectations from NCAs. In contrast, the Basel standard on which the framework is based is far less comprehensive and easier to understand. Also, the EU regulations apply to all banks whereas the Basel standards were initially developed for large internationally active institutions.

There is a general focus on ensuring proportionality in the prudential regulation. Although we acknowledge the need for sufficiently prudent management of interest rate risk amongst all EU/EEA banks, **ESBG believes the current framework is too complex and challenging to implement for smaller institutions with non-complex operations and limited market risk exposure.** Although there is a general possibility for institutions to, after a thorough and well-documented assessment, exclude certain risks if they can justify that those risks are not material, we believe there is a risk that supervisory practice will not be harmonized across the different jurisdictions. We hence believe that the guidelines and technical standards should provide more guidance on the application of the proportionality principle. This application should take into consideration the peculiarities of the national banking models and the interest risk inherent in national markets. In particular, small and non-complex institutions that are part of a group, subject to prudential requirement on consolidated level, should be excluded from the application of the strict thresholds for EVE.

Consultation paper on draft RTS on IRRBB standardised approach

General comments:

ESBG believes that new standardized methods for EVE and NII seem to be very calculation and maintenance intensive, but at the same time, they include several simplifications compared to the granularity that many banks' internal systems provide. Consequently, both banks and supervisors may risk losing insight from an interest rate risk management perspective if banks are required to apply this method by their NCA.

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?

Prepayments on floating rate instruments can be relevant for certain portfolios. Nevertheless, the impact on parallel-up scenarios is typically not material due the floating nature. Visible impact could occur in case of downward shock scenarios when floating loans are in the coupon or rate index floor. ESBG therefore believes that institutions should be free to decide if they want to include floating loans into the prepayment scheme.

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.

We see an inconsistency in the definition of stable/non-stable deposits: Article 7 (2) defines the identification of stable and non-stable. The separation should be based on observed balance changes due to movements in interest rates. This is in contradiction to Article 1 (14) where stable deposits are related to the current interest rate level only. In this respect, we are in favour of the definition in Article 1 (14) as the reaction to interest rate changes is covered by the core/non-core concept.

<u>Question 3</u>: 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.

N.A.

<u>Question 4</u>: 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?

N.A.

<u>Question 5</u>: 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?

We believe that the asymmetric treatment of the volatility add-on for bought and sold options will create issues in cases where the option is embedded in the loan contract and cannot be stripped from the loan contract (e. g. due to interest rate dependency of the notional redemption in annuity contracts or rate dependent prepayment behaviour).

<u>Question 6</u>: 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?

N.A.

<u>Question 7</u>: 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)?

The dNII measure including administrative expenses and the alfa calibration parameter even seems to add additional complexity and not fully account for the bank's flexibility to adjust their cost structure.

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

N.A.

<u>Question 9</u>: 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?

Generally, we agree with the simplifications, but we see an inconsistency for the outflow assumption in Article 23:

- Article 23 c (i) (3): methodology not consistent: outflow assumption for wholesale NMD = 14.5% which is not 0.7 * base as for all other cases. This should be 26.95% (=0.7*38.5%)

<u>Question 10</u>: 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?

N.A.

<u>Further comments</u>:

Appendix 1

- Appendix 1 (5) (a) – (c): reference to paragraph 2 should be replaced by paragraph 7

About ESBG (European Savings and Retail Banking Group)

ESBG represents the locally focused European banking sector, helping savings and retail banks in 21 European countries strengthen their unique approach that focuses on providing service to local communities and boosting SMEs. An advocate for a proportionate approach to banking rules, ESBG unites at EU level some 900 banks, which together employ more than 650,000 people driven to innovate at roughly 50,000 outlets. ESBG members have total assets of €5.3 trillion, provide €1 trillion in corporate loans (including to SMEs), and serve 150 million Europeans seeking retail banking services. ESBG members are committed to further unleash the promise of sustainable, responsible 21st century banking. Our transparency ID is 8765978796-80.

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