ABI Associazione Bancaria Italiana

ABI response to the EBA consultation 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 (EBA/CP/2021/38)

April 2022

POSITION PAPER

2022

GENERAL REMARKS

The Italian Banking Association (ABI) welcomes the opportunity to provide views about the forthcoming regulations implementing the new EU framework, outlined in Directive (EU) 2019/878 amending Directive 2013/36/EU (CRD5), on interest rate risk in the banking book (IRRBB) and credit spread risk in the Banking Book (CSRBB).

The CRD5 mandated the EBA to design standardised methodologies and simplified standardised methodologies for evaluation of risk in the economic value of equity (EVE) perspective and in net interest income (NII) perspective.

ABI remarks as regards the approaches outlined in the draft RTS are reported below.

They should be read under the premise that the standardised methodologies are deemed to represent a useful tool to ensure the proportionality of the framework and might be suitable to provide an acceptable estimate of risk, especially in case of banks of lower size and/or complexity.

However, they necessarily rely on simplistic assumptions which make them by definition less accurate than internal models, thus implying that, where the latter are available, mandatory switching to standardised methodologies should be limited to exceptional instances where severe deficiencies are observed in internal models.

FEEDBACK TO THE CONSULTATION QUESTIONS

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?

While there is some evidence of prepayments for floating rate instruments, mandatory inclusion of estimates in the standardised methodologies is not deemed appropriate, also in light of proportionality considerations. Among other things, the prepayments observed in last years for floating rate mortgages is linked to the very peculiar interest rate scenario, which determined an unprecedented low in fixed rates.

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.

While the proposed definitions do not raise specific concerns, ABI would recommend ensuring alignment of the definitions applied for the purpose of the standardised methodologies for IRRBB with those applied in the context of the liquidity framework, which in ABI's view, represent a simple and effective solution.

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.

Since determination and application of such parameters entail significant complexity, ABI would suggest raising the materiality threshold to limit their application, being the current thresholds extremely low, thus providing relief for a very limited number of banks (if any).

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?

As regards the treatment of fixed rate loan commitments, ABI would highlight that clarification is needed as regards the arrangements that shall be included. More precisely, ABI recommends clarifying that unconditionally cancellable commitments fall out of the scope of Article 11(3) of the draft RTS. Indeed, being unconditionally cancellable, it has not to be assumed that they represent an actual exposure to interest rate risk for the bank. They will be included in the calculation in case of drawdown, when the exposure materializes.

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?

The 25% increase in volatility is operationally complex to implement and considerably raises the overall complexity of the treatment of options in the context of the standardised approach on EVE. This should also be seen in light of the fact that the rationale behind such increase and its relevance are not clear.

As regards the latter, ABI would also recommend retaining in the RTS the discretion for banks of including or not bought options, provided in paragraph 130 of the Basel text "[…] *Banks have a choice to either include all bought automatic options or include only automatic options used for hedging sold automatic interest rate options*". This would allow for significant operational relief for those banks of lower complexity whose exposure to options is limited to specific products (e.g. mortgages with floored interest rates).

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?

Slotting of repricing cash flows in accordance with original maturity/reference term would require a very huge operational burden. Italian banks currently map items based on residual maturity and repricing date, while mapping of items in accordance with original maturity is not an information already available or easily retrievable in banks' systems. Therefore, ABI recommends deleting such request.

As regards in general the slotting of cash flows, ABI would highlight that reinvestment of cash flows of fixed rate instruments seems to be required in the context of the NII approach. This would be at odds with the constant balance sheet assumption and indeed is not required for the purpose of the NII SOT.

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)?

ABI agrees that in principle the standardised approach to NII should where possible leverage on the approach used for EVE calculations.

Anyway, with specific regard to the fair value component of Article 20, ABI's view (consistently with the response to the consultation on the draft RTS on the SOTs) is that such component should be excluded from the NII calculation. This would be all the more true in the context of a standardised methodology, where calculation of fair value changes would imply use of the intrinsically different models of each bank, thus jeopardizing the very concept of standardisation.

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?

In ABI's opinion, mandatory inclusion of an add-on for basis risk (and thus an analysis of such risk component) is disproportionate in the context of a standardised methodology.

Inclusion of basis risk should only be allowed, in the context of a standardised methodology, in case a bank considers it material.

On the contrary, mandatory inclusion of a basis risk component in the standardised approach might be misleading, inducing the idea that it is mandatory in any case for internal models, which would be at odds with the proportionality principle.

Assessment of basis risk should in any case be excluded in the context of the simplified standardised approach.

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?

In ABI's view an additional issue should be addressed, i.e. the exclusion of basis risk should be explicitly stated in the RTS (see the response to Question 8 above).

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?

RTS proposed entry into force 20 days after publication on Official Journal raises concerns.

It might be worth reminding that the legislator, in CRD5, had conveniently stipulated a one-year span between availability of the regulation (June 2020) and its application (June 2021).

Indeed, the banks interested in implementing the standardised approaches will need time to operationalize them, which will require non-trivial interventions on systems, as well as management of the consequences of the change on strategies and internal policies. All this requires time starting from the moment when banks have legal certainty on what they have to do, and when, since only to a limited extent the required actions can be planned in advance, in the absence of legal certainty.

This means that a reasonable timing for implementation is needed, and that such timing shall not be computed starting from the moment when the EBA delivers the final draft RTS, but from the publication on the OJEU.