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Finalisation of IRRBB and CSRBB Regulation on European Level

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Content

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01. Overview

On 20 October 2022, the European Banking Authority (EBA) published the final versions of the new guidelines for the management of interest rate and credit spread risks arising from non-trading book activities (IRRBB / CSRBB)[1] as well as the final drafts of the Regulatory Technical Standards (RTS) on standardised methodologies of IRRBB[2] and on the IRRBB supervisory outlier tests[3]. EBA's update of the guidelines constitutes the final implementation of the IRRBB requirements on European level as formulated by the Basel Committee[4] and formally mandated by the CRD V regulatory framework.

The new aspects of the final regulations are the formalisation of CSRBB requirements, the introduction of an outlier test on NII and the specification of the standardised methodologies for IRRBB. The new papers largely correspond to the consultation versions[5,6,7]. The critical remarks from the industry, especially regarding CSRBB, have been minimally accommodated.

The new guidelines will enter into force on 30 June 2023 for IRRBB and 31 December 2023 for CSRBB, thus replacing the old IRRBB guidelines[8]. The two technical standards will become directly applicable 20 days after their publication in the Official Journal of the European Union. National implementations are still pending.

02. Significant Changes

The subsequent sections summarise the main changes in the final documents as compared to the consultation versions.

2.1 IRRBB Guidelines

There have only been selective changes with respect to the requirements on IRRBB; they are summarised hereafter:

- Definition of Net Interest Income (NII): A new aspect is the distinction between 'net interest income measures' and 'net interest income measures plus market value changes'. The latter contain market value changes and replace the former 'net interest income measures' within the text of the guidelines.
  The leading view for internal IRRBB management goes beyond interest income and also comprises market value changes (as was already the case in the consultation version).

1 EBA/GL/2022/14: Final report on guidelines on the management of interest rate risk and credit spread risk arising from non-trading book activities, 20.10.2022

2 EBA/RTS/2022/09: Final draft RTS on standardized methodologies on IRRBB, 20.10.2022

3 EBA/RTS/2022/10: Final draft RTS on supervisory outlier tests, 20.10.2022

4 BCBS 368: Interest rate risk in the banking book, 08.06.2016

5 EBA/CP/2021/37: Consultation paper on draft guidelines on the management of interest rate risk and credit spread risk arising from non-trading book activities, 02.12.2021

6 EBA/CP/2021/38: Consultation Paper – Draft RTS on standardized methodologies on IRRBB, 02.12.2021

7 EBA/CP/2021/39: Consultation Paper – Draft RTS on supervisory outlier test, 02.12.2021

8 EBA/GL/2018/02: Guidelines on the management of interest rate risk arising from non-trading book activities, 19.07.2018

- Accounting standards: Previously, market value changes in the periodic perspective always meant fair value changes in the sense of IFRS terminology. This has now been generalised by the explicit mention of nGAAP (the national accounting standards).

- Materiality thresholds: A cross reference to the RTS on standardised methodologies has been included (see below).

- Inflation modelling: The explicit requirement of a scenario independent modelling has been discarded.

- Modelling of non-maturity deposits (NMD): Operational deposits from financial customers as defined in Article 27(1)(a) LCR Delegated Regulation may now be subject to behavioural modelling.
  For all deposits from non-financial customers as well as for operational deposits from financial customers, the weighted average repricing date is still constrained to a maximum of 5 years. This constraint refers to the entire amount of the aggregate portfolio (core and non-core).

The adjustments to the requirements on inflation and NMD modelling constitute a reaction to questions which arose during the consultation phase. With regards to other issues, e.g., the adequacy of internal methods or the application of standardised methodologies, the EBA did not make any modifications but refers to existing requirements and the necessity of an individualised treatment by the respective supervisory authority.

2.2 CSRBB Guidelines

Despite extensive critical feedback during the consultation phase, the requirements on CSRBB were only minimally adjusted and, for the most part, have not been elaborated further. Thus, there remains much capacity for interpretation concerning the implementation of the requirements, and it remains to be seen whether a clear market standard will develop.

The subsequent points summarise the main changes with respect to CSRBB:

- Delimitation from CVA risk: Overlapping or double counting with CVA risk shall be avoided.

- Clarification for excluding non-performing exposures: Not only exposures that are already under default but also those that are prone to default (i.e., non-performing) should be excluded from measuring CSRBB.

- Delegation of responsibility: Analogous to IRRBB, it is possible to delegate the responsibility for monitoring and steering CSRBB to senior management, expert individuals or an asset liability committee.

- Diversification effects: Diversification effects may also be considered for risk types other than IRRBB. Institutions should assess CSRBB separately from other risk types including IRRBB.

Moreover, the EBA has referred to the feedback and questions from the consultation phase:

- No general rules on methodology: In contrast to IRRBB, no specific requirements regarding the design and parametrisation of risk models are formulated (e.g., no sophistication matrix is defined). Accordingly, each institution may decide individually whether to apply value-at-risk based or scenario-based approaches.

- Definition of spread curves: For the definition of a generic spread curve, the institutions may take into account further institution-specific dimensions besides currency and rating (e.g., sector or country). However, the institutions are still obliged to prove that the consideration of idiosyncratic components within its risk measurements is conservative.

- CSRBB scope: The EBA clarified that the application of CSRBB is not exclusively constrained to instruments traded in active and liquid markets. Therefore, the CSRBB scope generally also comprises instruments for which no liquid reference market is available. However, the EBA does not further specify how to measure CSRBB for such instruments.

- Risk appetite: The definition of a risk appetite for CSRBB is required. However, the guidelines do not contain specific quantitative limits or capital requirements eminating from such limits.

- Exceptions to CSRBB requirements: The EBA does not define any exceptions, e.g. for special business models or for the determination of credit spread risk as part of credit risk. Decisions on this are only envisaged as part of the supervisory SREP dialogue.

2.3 RTS on Supervisory Outlier Tests

The key decision was to use the capital-based approach for calculating the NII supervisory outlier test. Other changes ensure the consistency of the RTS on outlier tests with the EBA guidelines.

- Capital based metric for NII: An institution fails the outlier test on NII if its delta NII between the baseline scenario and one of the two stress scenarios is greater than 2.5% of its Tier 1 Capital over a one year horizon.

- Specifications on market value changes: The EBA decided against the inclusion of market value changes in the outlier test on NII which marks a difference with respect to the requirements on internal IRRBB management (see above).

- Calibration of interest rate shocks: Interest rate shocks for foreign currencies, for which the annex does not provide any parameter values, are required to be recalibrated at least every five years.

- Materiality thresholds: A cross reference to the RTS on standardised methodologies has been installed (see below).

- Non-performing exposures: The definition of NPEs for the outlier test follows the CRR classification; the materiality threshold of 2% remains unaffected.

- Foreign currencies: Currencies other than the reporting currency shall be converted to the reporting currency at the ECB spot rate on the reference date. Furthermore, the constraints for the imputation of profits in foreign currencies have been reformulated.

- Discount curves: The requirement for applying a risk-free yield curve per currency is maintained. The example of a swap curve from the consultation version is replaced by an OIS curve. Moreover, the risk-free curve shall not include any sector-specific credit or liquidity spreads.

The specified methodology and thresholds for the supervisory outlier test on NII may pose a challenge to institutions as the parameters were calibrated during the low-interest period.

2.4 Materiality Thresholds

The standardised methodologies and simplified standardised methodologies for EVE and NII were minimally modified. However, the included materiality thresholds have been adapted. In a nutshell, the following threshold values are specified:

- Non-maturity deposits (NMD): 2%

- Fixed rate loans subject to prepayment risk: 5%

- Term deposits subject to early redemption risk: 5%

- Fixed rate loan commitments to retail counterparties: 2%

- Threshold on floating rate instruments for consideration of basis risks in NII: 5%

- Non-performing exposures (NPE): 2%

Compared to the consultation, the EBA has now clarified through explicit references in the guidelines and the RTS on the outlier test that the thresholds are also applicable beyond the standard metrics.

03. Conclusion

The salient points of the new regulations (as compared to the previously applicable guidelines from 2018) are as follows:

- The requirement of an NII perspective for CSRBB, the definition of a NII supervisory outlier test and the specification of a standardised methodology for NII, means that the NII perspective has gained more importance.

- The wording of the definition and scope of application of CSRBB has been revised. Depending on their interpretation, this results in substantial changes. Furthermore, the requirements on CSRBB governance were extended.

Altogether, with exception of the necessary decisions on the NII outlier test, there have been no major changes compared to the consultation versions of the documents. In particular, there remains much room for interpretation with respect to CSRBB requirements. Hence, based on their own analyses, the institutions have to decide on how to interpret and implement the requirements.

Do you have any further questions?

We would be happy to discuss the new requirements with you in detail and analyse the implications for your company.

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