Revised EBA IRRBB Guidelines

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1. Overview

In accordance with the announced update of the pillar 2 requirements [1], the European Banking Authority (EBA) published revised guidelines on the manage-ment of interest rate risk arising from non-trading activities (IRRBB) [2], the Supervisory Review and Evaluation Process (SREP) as well as institutions' stress testing, on 19 July 2018. The update of the EBA IRRBB guidelines constitutes a partial implementation of the IRRBB requirements of the Basel Committee on Bank-ing Supervision (BCBS) [3] on European level. Full compliance with Basel requirements will be achieved with the revision of CRD V / CRR II [4] in 2019/2020. More precisely with the enactment of the related technical standards provided by EBA, one to two years after the new framework comes into effect.

The key elements of the revised IRRBB guidelines are the requirement for the inclusion of IRRBB into the Internal Capital Adequacy Assessment Process (ICAAP) and requirements in regard to the governance of IR-RBB, the measurement of IRRBB in both earnings and economic perspective, the measurement of credit spread risk from non-trading book activities (CSRBB), and the calculation of the supervisory outlier test. Here the revised guidelines are largely similar to the consultation paper [5]. However, based on the re-sponses of the banking industry a number of amend-ments have been made to the guidelines to ease the implementation. In particular, the implementation deadline for the new guidelines has been extended to 30 June 2019. Institutions in SREP category 3 and 4 are granted an additional 6 months for the implementa-tion of CSRBB and the additional outlier test. The new EBA guidelines replace the previous version from 2015 [6].

2. Key Changes

The following points summarise key changes com-pared to the previous EBA IRRBB guidelines and indi-cate important differences when compared with relat-ed regulatory requirements and consultation papers.

- **Proportionality:** Following industry suggestions from the consultation, the proportionality princi-ple has been emphasised and is now mentioned explicitly in several paragraphs.

- **Outlier test:** The calculation of the six BCBS standard shocks is required in addition to the existing 200 bps shifts. The six BCBS shocks are used for an additional outlier test with a threshold of 15% of the tier 1 capital as an early warning signal. The requests of the banking industry, especially small and medium institutions, to conduct a quantita-tive impact study (QIS) for the new outlier test were rejected by EBA. They cited that the early warning signal only triggers a supervisory dialogue but not a supervisory measure. A QIS including these institutions is planned with the revision of the disclosure requirements in CRD V.

  Besides pension obligations, the evaluation of the outlier shocks also has to include non-performing exposures (NPEs). A concession, compared to the consultation paper, is the limitation that NPEs only have to be included if the NPE ratio exceeds the materiality threshold of 2%. The exclusion or in-clusion of commercial margins and other spread components in interest payments for the outlier calculation are both allowed provided the treat-ment is in accordance with the institution's inter-nal management and that competent authorities are notified regarding the choice.

  As before, one risk free yield curve per currency should be applied as a discounting curve. A ma-turity-dependent post-shock interest rate floor should be applied to each curve. This floor starts at the short end at -100 bps increasing by 5 bps per year up to 0 bps for maturities of 20 years or more. The floor does not apply to observed nega-tive rates smaller than the floor.

  Shocks have to be calculated separately for each material currency (accounting for more than 5% of the total assets/liabilities) while at least 90% of the non-trading book items have to be covered. Positive contributions have to be multiplied by a factor of 50% in the aggregation of shock results on a currency level. This is a significant concession compared with the consultation paper in which only negative contributions were considered.

- **CSRBB:** In accordance with BCBS, the EBA guide-lines require the monitoring and assessment of CSRBB despite massive criticism. However, follow-ing the consultation, the definition of CSRBB has been adapted and the scope has been limited tothe asset side. However, a detailed definition onCSRBB is missing and will only be provided in thecontext of the CRD V/ CRR II revision.

- **Earnings perspective:** The revised guidelines require that the effects on the fair value through other comprehensive income portfolio be included in the earnings perspective. This leads to a stronger focus on accounting effects in the earnings perspective, compared to the previous version of the EBA IRRBB guidelines and the BCBS IRRBB principles.

- **Stress tests:** Currency specific stress tests and the addition of negative interest rates in stressed scenarios are required for the measurement of Economic Value of Equity (EVE) and Net Interest Income (NII) risk measures.

- **Derivatives:** The guidelines require a separate measurement of the IRRBB contribution of interest rate derivatives. Specific risk limits for derivatives are not required, contrary to the consultation paper. Institutions shall monitor the changes in hedging strategies instead, especially when these strategies rely on derivatives.

- **NPEs:** Explicit regulations regarding the consideration of NPEs for the measurement of IRRBB have been introduced. In contrast to the consultation paper, the inclusion of NPEs is only required if the NPEs exposure is above a 2% materiality threshold (cf. outlier test).

- **Reporting:** The EBA guidelines formulate minimum requirements for the content of reports prepared for the management body or its delegates. In addition to the total IRRBB exposures, including information on exposures to gap, basis and option risk, the impact of model assumptions, derivatives, and fair value instruments1 on the EVE and NII measurement have to be included. This implies higher requirements on the IRRBB architecture; in particular it should be possible to combine information from different data sources (e.g. accounting data) with IRRBB risk figures. The general requirement of specific limits for each IRRBB risk type has been removed after the consultation. However, the EBA expectation is that these limits are still required if sub-risks are material.

- **Comparison with BCBS principles:** The revised EBA guidelines do not reflect all aspect of the BCBS 1 also Level 3 instruments principles. In particular, the definition or specification of a standard approach for the calculation of EVE and the requirement of the supervisory outlier test for NII are missing.

3. Conclusions

On the one hand, detailed responses of the banking industry have achieved significant concessions in the revised guidelines compared to the consultation paper, in particular, the amendment of the implementation period and a strengthening of the proportionality principle. However, on the other hand, the revised EBA guidelines do extend the IRRBB requirements from 2015 in a material way, particularly with the introduction of the new outlier test and the extension of the earnings perspective. Nevertheless, detailed requirements on the measurement of CSRBB are still missing.

References

[1] EBA: Pillar 2 Roadmap, 11/04/2017

[2] EBA: Guidelines on the management of interest rate risk arising from non-trading book activities, 19/07/2018

[3] BCBS 368: Interest rate risk in the banking book, 08/06/2016

[4] European Commission: Proposal CRD V/CRR II, 23/11/2016

[5] EBA: Draft Guidelines on the management of interest rate risk arising from non-trading book activities, 31/10/2017

[6] EBA: Guidelines on the management of interest rate risk arising from non-trading activities, 22/05/2015

1 also Level 3 instruments

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