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| CONSULTATION comments (EBA/CP/2021/3)  |
| To | : European Banking Authority |
| From | : NWB Bank |
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| Date | : 4 april 2022 |
| Subject | : [Subject] |
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NWB Bank appreciates the opportunity to respond to EBA’s consultations on IRRBB/CSRBB. The Bank also draws EBA’s attention to the responses submitted by the EBF, the European Banking Federation, the NVB, the association of Dutch banks, and EAPB, the European association of public banks. The Bank would like to draw EBA’s attention to the purpose served by promotional banks in financing socially beneficial activities. A strong focus on fair valuation and market valuation carries the risk that the guidelines become unduly burdensome to promotional banks and, consequently, to the societies they serve.

We submit the following response to the Consultation Paper EBA/CP/2021/3 on the “***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***” for your further consideration.

**General remark:**

The bank asks that EBA recognises promotional and public banks provide financial services and funding for projects that support sustainable economic and social development. They are ‘not-for-profit’ banks. They, typically, provide their customers an alternative to capital markets that fail to price in the benefits of sustainable economic and social development to the community at large. They offer loans tailored for the needs of individual clients and commit long term to their clients. Consequently, the banking books of promotional and public banks will hold loans for which there are no deep and liquid markets. Commercial margins and spreads, generally, will reflect the banks’ missions and not the interest rate environment.

The bank has the following general questions and comments relating to the proposed guidelines on IRRBB and CSRBB.

● As a promotional bank, NWB bank grants loans it intends to hold to maturity. An economic-value-of-equity (EVE) approach to IRRBB, however, focusses on the liquidation value of loans. When EVE and net-interest-income (NII) approaches conflict, the latter may be decisive for management decisions. The possibility to make that decision should be maintained.

● The Bank asks EBA to allow institutions sufficient time after publication of the final guidelines for the implementation of changes to the current guidelines.

● The Bank asks EBA to explicitly state whether interest-sensitive assets covering an institution’s equity must be included in the measures for IRRBB and CSRBB.

Referring to paragraph 83 of the proposed guidelines and our general remark above, the Bank asks EBA to clarify whether the principle of proportionality applies where institutions such as promotional and public banks set commercial margins that reflect their missions and not the interest rate environment.

**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 nonfinancial 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.***

We respond EBA with reference to Question 1 as follows.

The Bank does not foresee consequences for its present portfolio, unintended or not, from the cap on the repricing maturity for non-maturity deposits.

As promotional bank, the Bank offers public entities that are its core customers a deposit facility for operational purposes. The Bank does not offer deposits to retail customers. Other deposits include deposits the bank holds with the central bank and collateral deposits. These all have short-term repricing maturities.

The Bank can foresee a situation where it enters into a loan agreement with a wholesale customer requiring it to deposit the non-allocated funds with the Bank. In such a case, the five-year cap on the repricing maturity should not apply. It, especially, should not apply when the interest on the deposit is linked to that of the loan granted.

**Question 2:**

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

We respond EBA with reference to Question 2 as follows.

● The Bank asks EBA to clarify how it can reconcile general “minimum elements for supervisors’ assessment” with the principle of proportionality referred to in the proposed guidelines.

Paragraph 119(a), explicitly, considers the internal management system for managing IRRBB to be non-satisfactory if risk measures do not capture risk in an “economically justified manner.”

● The Bank refers to its general remark, above, and asks EBA to clarify what constitutes an “economically justified manner.” Economic concepts like ‘fair value,’ ‘market prices,’ and ‘Economic Value’ are not necessarily applicable to promotional banks.

Promotional and public banks provide financial services and funding for projects that support sustainable economic and social development. The bank offers those services and funding at a ‘fair’ price. ‘Fair price’ should not be confused with the accounting-concept of ‘fair value’ or economic concept of ‘market value.’ ‘Fair value’ and ‘market value’ are concepts based on the existence of sufficiently deep and liquid markets for instruments or close substitutes for such instruments. Frequently, such markets also fail to price in the benefits to society provided by promotional and public loans. Instruments for which no such markets or close substitutes exist make up upward of 90% of the banking books of promotional and public banks.

When the Bank, in accordance with applicable generally accepted accounting principles, does not value assets and liabilities at fair value, EBA guidelines should not overrule such principles and impose a parallel fair-value administration. The Bank, consequently, expects to invoke the principle of proportionality to avoid the competent authority requiring the use of the ‘standardised methodology.’ The Bank opposes the obligatory use of the ‘standardised methodology’ for being theoretical, inaccurate, burdensome, and prone to spurious risk measures.

**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?***

We respond EBA with reference to Question 3 as follows.

The definition of CSRBB relies heavily on the concept of ‘market prices’ for credit and liquidity risk. The Bank asks EBA to provide examples of how to identify credit spread and liquidity spread components for instruments that do not trade in deep and liquid markets, and have no close substitutes traded in such markets.

The Bank does not consider the use of traded-bond indices a reasonable alternative for deriving market prices of credit-spread risk. Practically, the Bank does not monitor these as they are irrelevant to the Bank’s business. Unless yield data are readily available, it requires insight into the underlying portfolio and cash flows from it to derive yields and risk premiums. This would be a costly exercise that does not contribute to the business model. Furthermore, the use of indices compiled on ratings assigned by rating agencies ignores any criticism on past failure to capture credit deteriorations and the sticky nature of such ratings. It, furthermore, is questionable whether any available index is sufficiently diversified.

Promotional and public banks, generally, set spreads that reflect the banks’ missions and not the interest rate environment. As such, promotional and public banks may provide their customers protection against changes in the market prices of risk. Imposing a risk management system based on market pricing of liquidity and credit risk ignores this purpose of promotional and public banks. A promotional bank, further, can apply a funds transfer-pricing mechanism to mitigate changes in market prices of credit and liquidity risk it experiences in funding its lending activities. Paragraph 124 would prevent exclusion of such instruments.

● The Bank asks EBA to clarify how it should manage CSRBB where it is contrary to its purpose and business model.

● The Bank asks EBA to provide examples of how mitigating mechanisms such as funds transfer pricing may be considered in the measurement of CSRBB.

● The Bank asks EBA to clarify whether it should distinguish between liquidity and credit risk in its monitoring and management of CSRBB.

● The bank asks EBA to clarify whether liquidity risk as part of CSRBB also extends to the cross-currency basis spread for currency swaps.

**Question 4:**

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

We respond EBA with reference to Question 4 as follows.

Promotional and public banks provide financial services and funding for projects that support sustainable economic and social development. They offers their customers an alternative to financial markets that fall to price in social benefits to the community in which they operate. Promotional and public banks commit to their customers for the long term. Liquidation of loans that fund projects that support sustainable economic and social development, generally, is undesirable. Consequently, many of the loans granted by these institutions do not trade in deep and liquid markets. Instruments for which no such markets or close substitutes exist can make up upward of 90% of the banking books of promotional and public banks.

Imposing principles of ‘fair value’ and ‘market pricing’ are contrary both to the mission of a promotional or public bank and the long-term commitment to its customers. CSRBB should not be a consideration for financial services and funding for projects that support sustainable economic and social development for the sole purpose of regulatory reporting. Paragraph 124 of the proposed guidelines prohibit institutions to exclude any instrument in the banking book from the perimeter of CSRBB ex ante. Institutions should document and justify the potential exclusion of instruments. For promotional and public banks, this would result in the requirement to document and justify exclusion for the larger part of instruments in their banking books. This would be unduly cumbersome.

Additionally, the Bank does not consider the use of traded-bond indices a reasonable alternative for deriving market prices of credit-spread risk. Practically, the Bank does not monitor these as they are irrelevant to the Bank’s business. Unless yield data are readily available, it requires insight into the underlying portfolio and cash flows from it to derive yields and risk premiums. This would be a costly exercise that does not contribute to the business model. Furthermore, the use of indices compiled on ratings assigned by rating agencies ignores any criticism on past failure to capture credit deteriorations and the sticky nature of such ratings. It, furthermore, is questionable whether any available index is sufficiently diversified.

● The Bank asks EBA to clarify how it will apply the principle of proportionality to promotional and public banks for which instruments that do not trade in deep, liquid markets and that have no close substitutes traded in such markets make up the larger part of their banking book.

The Bank further remarks that generally accepted accounting principle may require a bank to carry any derivative at fair value. Pricing theory for derivatives uses the possibility to hedge risks eliminating CSRBB in particular. Such instruments do not have a credit spread element and should be excluded ex-ante .

● The Bank asks EBA to clarify whether article 124 extends to derivatives. The Bank asks EBA to provide example of how to identify CSRBB for interest rate, currency, and credit risk derivatives.

**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?***

We respond EBA with reference to Question 5 as follows.

Paragraph 160 of the draft guidelines states ‘diversification between CSRBB and IRRBB may be possible.’

● The Bank asks EBA to clarify whether institutions must manage IRRBB and CSRBB separately. The Bank asks EBA to provide an example of how institutions may consider diversification benefits.

NWB Bank