Consultation Paper: 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 (EBA/CP/2021/37, CSRBB)

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 the documents being only two articles in the CRD (art 84 (5) and (6) and art 98 (5a)), the guidelines EBA are currently consulting consist of 176 pages combined. In addition to this comes EBAs SREP guidelines whose new version has just been released by the EBA (on March 18th 2022 with very limited time to assess the reciprocal implications of these documents) as well as guidelines and supervisory expectations from National Competent Authorities (NCAs). In contrast, the Basel standard on which the framework is based is far less comprehensive and easier to understand. Also, the EU framework applies to all banks whereas the Basel standards initially were developed for large internationally active institutions.

There is a general focus on ensuring proportionality in the prudential regulation in the EU. Although we acknowledge the need for sufficiently prudent management of interest rate risk amongst all EU/EEA banks we believe the current framework is too complex and challenging to implement. There is a general possibility for institutions, after a thorough and well documented assessment, to exclude certain risks if they can justify that those risks are not material. However, we believe there is a risk that supervisory practice will not be harmonized across the different jurisdictions. Hence, we 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.

As a general comment the draft guideline maintains continuity in the 2018 guidelines for identifying, managing, and measuring the interest rate risk of internal systems. However, some new elements have been imported which should be reviewed further. Such are the entirely new section on CSRBB identification, assessment, and monitoring. The definition of CSRBB in the consultation paper covers exposures not typically thought to be in scope in industry (everything vs only assets held at fair value), and it introduces completely new EV and NII metrics implemented IRRBB also to CSRBB, but without providing an equivalent level of detail on the metrics / SOT's calculation.

Furthermore, we find that balances of mortgage lending funded by covered bonds, where the values of mortgage loans have a close correspondence with the values of the corresponding covered bonds cf. Article 33 (3-4) of CRR could be excluded from the CSRBB and the IRRBB since the market risk is very restricted.

This results in a scope for CSRBB which appears too wide and open for banks and local regulators for justification on what positions should and should not be included based on internal assessment. This approach does not seem prudent from a regulatory point of view and could lead to asymmetries on how banks or regions account for CSRBB. It is recommended to review the scope and to align it with 2018 EBA guidelines.

With regards to CSRBB the banks have large freedom on how to incorporate this element in the overall IRRBB reporting. It might be useful to define a standard methodology on how this should be handled (sensitivity to a 1bp independently from correlation with other risk factors).

The overall IRRBB framework has some components which receive large focus due to their relevance for many European banks, which are however less critical or even marginal for banks in certain jurisdictions, e.g. Norwegian banks (such as option risk). Although there is a possibility for the individual bank to argue that certain factors are not relevant, there is a risk that the national supervisory authorities will not accept this and require the bank to take those into account. For the smaller banks, application of the new framework can entail a lot of work with little benefit. The larger ones instead risk being forced using (either in addition or as a replacement to) a standardized method which is:

- far less granular and sophisticated than the methodologies implemented in those institutions,
- a poorer risk management and reporting tool,
- still very demanding with regards to resources, systems and data requirements.

Vice versa, the framework provides little guidance for other elements e.g. equity capital treatment, cross currency basis swaps (banking book hedging instruments held at fair value) which might be less relevant for the majority of European banks, but that are still relevant for certain banks in scope for the regulation. These banks lack the required guidance on how to interpret the regulatory framework. At the same time the national authorities are left ample margins to perform local adjustments that would represent a source of inequality / disparity among jurisdictions.

We believe that the guideline should state explicitly that the marked conditions across the EU/EEA differs and that certain risks will hence be more or less relevant in different jurisdictions (and across institutions).

The new guideline still requires the bank's IRRBB framework to include limits both for earnings and economic value of equity (EVE). It is important that the limits are not too rigid. This is especially due to the peculiarities of the Norwegian banking model, where the banks have large response flexibility to market distress situations, through interest rate changes due to the large proportion of floating interest rate loans the introduction of too rigid limit structures, could create negative repercussions on the banks maneuvering flexibility and systemic stability. In article 114 it is stated that "Institutions should avoid taking income stabilization positions that significantly reduce their capability to adjust to significant changes in the underlying economic and business environment." This article applies to the investment term assumptions for equity, but the principle should also apply to other parts of the framework.

Q1: 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 non-financial 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.

The CRD/2019/878 article 98 a paragraph 5a was inserted which included the following EBA mandate: *"EBA shall develop draft regulatory technical standards to specify for the purposes of paragraph 5 the following: …5a (b) and 5a (c) in light of internationally agreed standards, the common modelling and parametric assumptions, excluding behavioural assumptions, that institutions shall reflect in their calculations of the economic value of equity"…."*.

As pointed out in attached general remarks, according to CRD 98 5a (b) and (c) behavioural assumptions are not included in EBA's mandate according to which EBA is preparing the new EBA RTS EBA/CP/2021/36 specifying supervisory shock scenarios, common modelling, and parametric assumptions in the context of what constitutes a large decline for the calculation of the economic value of EVE and NII. If behavioural assumptions will be included in EBA Guidelines, which documentary is also part of the same topic, this could be seen as a working around the EBA Mandate for assumptions in SOT specified in EBA/CP/2021/36.

Q2: Do respondents find that the criteria to identify non-satisfactory IRRBB internal models provide the minimum elements for supervisors' assessment?

As opposed to the desired outcome, the new version of the guideline sets very broad criteria to define "Non-satisfactory IRRBB internal systems", even in respect of the principle of proportionality. Our understanding is that the supervisory expectation is compliance with all requirements in the EBA guidelines. Failure to fulfill the supervisory expectations could be that national authorities require the institution to use the standardized or simplified standardized method. NCAs are granted a substantial amount of discretion regarding the valuation of the institutions internal measurement systems (IMS) and leaves the possibility for large variations among and within jurisdictions.

To ensure good risk management practices and harmonized supervisory practices we believe this national discretion should be reduced through specific criteria that must be fulfilled for the NCAs to require this. Without a clear definition of what the individual authorities mean as "material components of the interest rate risk (gap risk, basis risk, option risk)" and of "robust and economically justified … dimensions of risks for significant assets", it is hard to create common definitions. A minimum requirement formulated as "In compliance with these Guidelines" (Article 118) is not very specific. We also believe it should be specified that a criterium for requiring an institution to use the standardized or simplified standardized approach must be that it improves the institutions risk management.

The standardized approach is less granular than IMSs i.e. for example limiting the assumptions to a static balance sheet and a specific time period (dNII metric calculated over one year). Requiring a bank to replace its IMS could potentially have a negative effect on risk management as it might no longer capture risks that are significant for the specific institution and put too much emphasis on others that are not.

Q3: 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?

The CP envisages dramatic changes to the definition and scope of Credit Spread Risk in the Banking Book (CSRBB) while the July 2018 EBA Guideline already implemented the BCBS Standard that has not changed since then. The envisaged changes are not only not substantiated but they would also introduce significant confusions and complexities. CSRBB relates to 'market credit spread' / 'market price of credit risk' / 'market liquidity spread'. All of which refers to 'market', which is welcome as CSRBB belongs to the Market Risk chapter in the CRR. However, the different components generate confusion. The new framework opens for potentially including all fair value instruments on the banks' balance sheets and the banks are required to justify excluding any of these instruments. This puts an excessive operational burden on the banks and allows for differences in interpretation and thus practice across banks and jurisdictions. The definition should be cleared, to align with a CRR definition of CSRBB.

The usefulness separating the market-risk components into CSRBB and IRRBB, as argued in BCBS/2016/04, is primarily to monitor and assess CSRBB, since CSRBB can be considered a sub-risk component of IRRBB. However, the new EBA GL suggests a severe expansion of the CSRBB framework and scope, which stretches not to just monitor and assess CSRBB, but to also create a separate limit and management structure. This is in contrast with previous EBA GL and also with the spirit of BCBS, as management and mitigation are limited to IRRBB. This expansion is questionable from a governance perspective and not proportionate to the materiality of CSRBB in comparison with rest of IRRBB.

The exclusion of the idiosyncratic credit spread is noted but Banks will most likely develop measures that seek to measure the aggregate CSRBB, rather than seek to break the risk into the suggested component parts. This aggregate measure will most likely include the risk attached to an institutions credit quality, so will be very conservative in nature and will over represent the risk when compared against other jurisdictions.

Where we have concern is around the perimeter, as the majority of the Banking Book has no "market" index to reference. From reading point 124 of the proposed guidelines, instruments should only be excluded from the perimeter when they are not sensitive to credit spread risk. There appears to be a disconnect between this paragraph and that of 120, as the former is linked to sensitivity to credit risk while the latter is linked to "market" related measures for credit spread. The proposed negative boundary perimeter, where Banks have to justify what is included, will lead to different measures being adopted across Banks. To align with the requirements of paragraph 120, we consider that a positive boundary perimeter should be used, namely only assets that have external transparency to a deep and liquid market pricing. As such, the CSRBB measurements should remain linked to assets and a positive boundary should be used where only assets that can be linked to deep and liquid tradeable markets are included. As such, CSRBB across Banks will become more aligned and therefore be more comparable.

Q4: As to the suggested perimeter of items exposed to CSRBB, would you consider any specific conceptual or operational challenge to implement it?

Compared to the previous EBA Guidelines 2018 the monitoring is no longer limited to the assets, also liabilities are planned to be included. The extension introduced in the consultation paper deviates from the EBA Guidelines 2018 (published only three years ago), which is based on BCBS April 2016 document. The Basel regulation for large internationally active institutions has not changed.

Q5: Is the separation of IRRBB and CSRBB sufficient to understand where the Guidelines apply to:

IRRBB only

CSRBB only

Both IRRBB and CSRBB?

The guidelines should include clear criteria for determining which exposures are to be included.

The definition of CSRBB, which is part of the EBA mandate, is insufficient and, from the perspective of the supervised institutions, lacks foreseeability.