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EBF RESPONSE TO THE EBA CONSULTATION PAPER ON THE DRAFT GUIDELINES ON THE MANAGEMENT OF INTEREST RATE RISK ARISING FROM NON-TRADING BOOK ACTIVITIES (EBA/CP/2017/19)

Summary of key comments

1. The European Banking Authority (*EBA*) should not front run the European process

While we agree that *qualitative* aspects of the Basel Committee on Banking Supervision (*BCBS*) Standards n°368[1] on Interest Rate Risk in the Banking Book (*IRRBB*) could be factored in *EBA* Guidelines, we believe such Guidelines should *not* factor in any *quantitative* components while they are being discussed by the European legislators.

EBF strongly recommends EBA to wait and not front run the ongoing European legislation process for the adoption of the level 1 text (Capital Requirement Directive #5 and Capital Requirement Regulation #2)**.**

Any new quantitative requirements, notably the revised Supervisory Outlier Test (*SOT*) with a suggested 15% threshold, even when presented as an 'Early Warning' indicator, should be subject to Quantitative Impact Studies (*QIS*'s) held at the level at which it is envisaged to apply (i.e. Credit Institution and Group consolidated level). Such *QIS*'s would be consistent with the better regulation objective, and inform both the co-legislators and the industry on the suitability and potential impacts of the implementation of such quantitative requirements in Europe.
It should be reminded that the *BCBS* standards, meant to be applicable to large and internationally active banks, have *not* been subject to such a *QIS* process at BCBS level. Indeed, the *BCBS QIS* held in 2015 did not enable to measure the final *BCBS* proposal.

[1] https://www.bis.org/bcbs/publ/d368.pdf

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While large and internationally active European banks participated, at consolidated level, to the *BCBS QIS*, the 15% threshold on the revised *SOT* was not tested on the individual entity level.

EBF urges EBA to launch QIS's to consider whether the envisaged new requirement should apply to consolidated level only, or, in addition, to individual European Union (*EU*) Credit Institutions not subject to capital derogations as defined in Article 7 of Capital Requirement Regulation (EU) n° 575/2013.
Such QIS's are pre-requisites to set any new quantitative requirement, notably referring to:

- The interest rate shock scenarios for measuring SOT, which should be set at a level reflective of the 15% of Tier 1 capital threshold.
- The calculation requirements (e.g. regarding: embedded automatic or embedded behavioural options, or currency aggregation)

Once finalized, potentially adjusted to the European environment, we agree with *EBA* and *BCBS*, that any *SOT* should only be a warning indicator that triggers a discussion with the supervisors, without any automatic supervisory measures. This is consistent with recognizing that SOT is *not* a risk metric measure, and does enable to identify or quantify any capital need.

Finally, in the implementation of the *BCBS* Standards at *EU* level, the impact on the global level playing field should be considered, to avoid putting European banks in a competitive disadvantage.
We recommend the introduction of any new requirements as contingent on similar implementations in major supervisory jurisdictions. It should be reminded that the previous *BCBS* standards on *IRRBB* have not been implemented in the US regulatory framework (hence, SOT does not exist in the US), and there is no known plan to implement the current *BCBS* Standards on *IRRBB*.

2. Some components of the draft Guidelines are irrelevant

The Credit Spread Risk in the Banking Book (*CSRBB*) is not only vaguely defined as '*any kind of spread risk of interest rate sensitive instruments that is not IRRBB or credit risk*', but it simply does not relate to *IRRBB*. For both reasons, ***EBF* urges to delete reference to *CSRBB* on *IRRBB* Guidelines**.

The draft Guidelines recommend that 'a *dedicated set of risk limits should be developed to monitor the evolution of hedging strategies that rely on instruments such as derivatives, and to control mark-to-market risks in instruments that are accounted for at market value*' (§44(f)). As all derivatives are accounted for at market value, this would require putting limits on derivatives that are used to mitigate *IRRBB*. It would be odd that a supervisory framework is developed to *prevent* risk mitigation by banks. **This is a fatal flaw of the draft Guidelines that *EBF* urges to delete**. If the intent is to make sure that other dimensions of risks relating to derivatives are captured (e.g. counterparty risk), it is reminded that those dimensions are dealt with in other regulatory requirements.

3. Some components of the draft Guidelines should be clarified

The draft Guidelines should distinguish the recommendations that apply to '*IRRBB considered in isolation*' from those that apply to '*IRRBB as contribution to a broader framework*':

- Illustration of recommendations which relate to '*IRRBB in isolation*':
  - Measurements in both economic value and earnings;
  - Supervisory Outlier Test;
  - Internal capital for *IRRBB* (cf below);
  - Risk appetite statement metrics for *IRRBB;*
  - Governance
- Illustrations of recommendations which relate to '*IRRBB as contribution to a broader framework*':
  - Ramifications on- or from- model, market, liquidity, credit and operational risks (which are dealt with by other regulatory requirements) or accounting (e.g. effectiveness);
  - Capital buffer (cf below).

As for internal capital for IRRBB, **we welcome the clarification that there is a need to hold internal capital for *IRRBB* to the extent that there is a risk of loss** (§30(c)&(e)).This would be even clearer if this was described as a general principle, and explicitly mentioned in the economic value component.

As mentioned above, it should be clarified that **the internal capital buffer referred to in paragraph 31 relates to the holistic stress test, covering all material sources of risk, including *IRRBB*, in combination** with other risks (i.e. not IRRBB considered in isolation).

In the *SOT*, it should be reminded that the BCBS does not consider a 5-year cap for banks adopting Internal Management System (*IMS*). It is noticeable that *EBA* intends to apply the *BCBS* standards but has introduced such a constraint that is absent in the *BCBS* standards. ***EBF* recommends not to apply any such cap.**
Should such a cap be maintained, it should be clarified if the 5-year cap on the assumed behavioural repricing date applies to either *deposits without any specific repricing date or* to *non-maturity deposits*. Indeed, the two notions are not the same (a *non-maturity deposits* can have repricing dates, and *non-repricing deposits* are not necessarily *non-maturity deposits)*. *EBF* recommends applying such a cap to *non-maturity deposits*. Those changes would make it consistent with paragraph 17(o) of the Executive Summary: '*non-maturity deposits: maximum average [repricing] maturity to be used of 5 years*'.

It should be clarified that ***the requirements*** to '*be capable of fully and clearly recording all transactions made by the institution, taking into account their IRRBB characteristics*' (§53(b)) and to '*enable the institutions to fully measure, assess and monitor the contribution of individual transactions to their overall exposure*' (§53(e)) **apply at**

individual institution level, and do *not* apply at consolidated level. That is to say that an entity in a Group should meet this requirement, but there is no requirement to have *all* individual *transactions* available at the consolidated level (typically at Head Office level).

4. Some components of the draft Guidelines should be simplified

We believe that the draft Guidelines should be simplified:

- The six interest rate shocks to use for the *SOT* are unnecessarily burdensome and do not add value to this tool compared to the current situations in which two parallel up/down scenarios are envisaged.
- The requirement to define '*the risk appetite statement for IRRBB should be expressed in terms of the maximum acceptable short term and long term impact of fluctuating interest rates on both earnings and economic value*' is not only not clear (the articulation between short term and long term on one side, and earnings and economic value on the other side is not clear), but is also overly prescriptive. This should be simplified into '*the risk appetite statement for IRRBB should be expressed in terms of both earnings and economic value*'.
- The requirement to identify internal capital for *IRRBB* on economic value and earnings is a source of complexity as it requires articulating the two components to ensure that there is no double counting.

4. Effective Date

Banks will need a year to implement the Guidelines after the release of the final version. Preparations for implementation on the basis of the draft guidelines is only possible to a very limited extent, given the lack of clarity of the draft Guidelines on a number of topics. It should also be confirmed that the new requirements introduced by these Guidelines will not be required by any European Competent Authority before the application date – this is especially the case for the implementation of the new additional 15 percent threshold for the *SOT* in small and medium-sized banks without any prior quantitative assessment.

Detailed comments:

Question 1: Are the definitions sufficiently clear? If not, please provide concrete suggestions and justify your answer.

<u>Interest rate risk</u>

Interest rate risk is defined as the "*current or prospective risk to both the earnings and economic value of institution arising from adverse movements in interest rates that affect interest rate sensitive instruments, including gap risk, basis risk and option risk*". We propose to delete the words '*current and prospective*' as *prospective* risk to economic value and *current risk to earnings* would be unclear as it would require factoring in assumptions to derive 'forward looking economic value' and it is difficult to understand what could be 'current earnings'.

<u>Scope of application</u>

It should be clarified whether the guidelines apply at solo, sub-consolidated or at the highest consolidated level. The European banking industry supports the application of those requirements only at the highest level of consolidation of EU Credit Institutions, not subject to the capital derogations of Article 7 of Capital Requirement Regulation (EU) n° 575/2013.

We suggest that the new 15% threshold could be considered to be applied to a more granular level than to the highest level of consolidation (eg small and medium sized banks that are not internationally active) only after that quantitative impact studies on the potential ramifications have been completed and analyzed. This would inform both competent authorities and the industry on the impact of the implementation of this *BCBS* criterion. Until now, the new threshold was not tested on the individual entity level, nor for smaller institutions.

<u>Credit spread risk from non-trading book activities (CSRBB)</u>

CSRBB is defined as any kind of spread risk of interest rate sensitive instruments that is not *IRRBB* or credit risk. It is difficult to understand why a *CRSBB* that is defined as not IRRBB is included in a *IRRBB* paper. The ramifications of factoring in *CSRBB* in an *IRRBB* are unclear. We would expect that *EBA* adopts a critical thinking of an inconsistency in the *BCBS* paper. ***The EBF* urges to delete the reference to *CSRBB* on *IRRBB* Guidelines**, and to issue another paper on *CSRBB*.

In this separate *CSRBB* paper, the definition and the scope of application would need to be clear: what is meant by credit risk in this definition and how this should be distinguished? Illustrative examples should be provided

Basis risk

The Guidance defines basis risk as '*arising from the impact of relative changes in interest rates on interest rate sensitive instruments that have similar tenors but are priced using different interest rate indices. It arises from the imperfect correlation in the adjustment of the rates earned and paid on different interest rate sensitive instruments with otherwise similar rate change characteristics'*.

This definition only refers to changes in the spread between similar tenors, e.g. between 3M Euribor and 3M government debt instruments.

However, paragraph 86, table 2 seems to both limit the scope to '*derivatives and hedging instruments*' and broaden the scope to '*timing difference neglected by gap analysis*'.

We suggest modifying the definitions such as: '*arising from the impact of relative changes in interest rates on interest rate sensitive instruments ~~that have similar tenors but are~~ priced using different interest rate indices. It arises from the imperfect correlation in the adjustment of the rates earned and paid on different interest rate sensitive instruments with otherwise similar rate change characteristics*'

Interest rate sensitive instruments

Interest rate sensitive instruments are defined *as assets, liabilities and off-balance sheet items in the non-trading book which are either interest rate sensitive or have an impact on IRRBB*. It is not clear what kind of impact on IRRBB is being referred to. Clarification would be appreciated.

General provisions

Question 2: Are the guidelines in section 4.1. regarding the general provisions sufficiently clear? If not, please provide concrete suggestions.

Paragraph 18

This paragraph again makes a very general statement around CSRBB and does not provide any additional clarity. It is unclear for what instrument types does CSRBB need to be calculated. **Again, *EBF* urges to delete reference to *CSRBB* on *IRRBB* Guidelines.**

Question 3: Do you agree that cash flows from non-performing exposures (NPEs) should be net of provisions and treated as general interest rate sensitive instruments whose modelling should reflect expected cash flows and their timing for the purpose of EV and earnings measures? If not, please provide concrete suggestions and justify your answer.

Like many items in the banking book, Non Performing Exposures (*NPE*'s) should be factored in the *IRRBB*-framework based on banks' internal models, and should apply the principle of materiality. That is the reason why we suggest replacing paragraph #16 by '*Institutions should consider non-performing exposures and ~~(net of~~ provisions~~)~~ ~~as interest rate sensitive instruments~~ for the measurement, in earnings and economic value, and management of their IRRBB ~~reflecting expected cash flows and their timing~~ only if they are considered as interest rate risk instruments according to internal approaches'*. The last portion of the initial paragraph adds no value specific to *NPE*'s.

Capital identification, calculation and allocation

Question 4: Are the guidelines in section 4.2. regarding the capital identification, calculation, and allocation sufficiently clear? If not, please provide concrete suggestions and justify your answer.

We understand that there is a need to hold internal capital for *IRRBB* to the extent that there is a risk of loss (eg §30(c)&(e)). We welcome this clarification, though we recommend making it clearer as a principle.

Paragraphs 23, 24 (a) ,26 (e) 30(b) and 31 should be modified as they could suggest that banks should hold capital against *variability risks*, even when they are not *losses*, but merely an opportunity loss. The wording of paragraphs n°30(b) and n°26 should be symmetrical. A capital charge should only be required when the bank is exposed to a *risk of loss* as opposed to a *variability risk*. We understand that the risk of loss should take into account embedded gains and embedded losses, if any.

Any capital requirement due to potential reduced earnings should be excluded from this guideline. The objective of the IRRBB Guideline is to prevent banks from losses and not from reduced earnings (Paragraph 31).

Hence, Paragraph 23 should be modified accordingly in '*Institutions should demonstrate that their internal capital is commensurate with the level of IRRBB, taking into account the impact on internal capital of potential ~~"changes"~~ losses ~~in the economic value and future earnings~~ resulting from changes in interest rates. Institutions should ~~are~~ not ~~expected~~ to double count their internal capital for EV and earning measures.*'.

We understand that the articulation between economic value and earnings component is left to the bank, notably to ensure that there is no double counting.

However, some points should be clarified:

- The identification of capital needs should be based on institutions' actual level of risk. It is interesting to identify what would be the potential capital needs *if* the Risk Appetite Statement (*RAS*) limits were fully used, however the potential capital needs should reflect actual risks and not assumed risks. Besides, it should be noted that *RAS* metrics and limits usually refer to *variability risk* while potential capital need refers to *loss risk*.
- We recommend modifying paragraph 26 into '*capital adequacy assessments for IRRBB should consider ~~factor in~~ the following*:' as it needs to be consistent with the risk identification process and the materiality principle).
- Similarly, we recommend modifying paragraph 30 into '*In considering whether an allocation of internal capital should be made in respect of IRRBB earnings, institutions should ~~take into account~~ consider the following:*'. As paragraph 30 refers to earnings, it is inconsistent to mention the other comprehensive income. We recommend deleting 30(d) '…
- In paragraph 26(c), it should be clarified that the sensitivity of metrics to imperfect modelling assumptions should be measured, but that this should *not* lead to identifying capital need for *IRRBB* as it is not purely IRRBB-driven. It would make more sense to consider the changes in behavior, competition, business models… in the framework of holistic stress tests, where those sensitivity analyses would be typically addressed as *business risk.*
- it should be clarified that the internal capital buffer referred to in paragraph 31 relates to the holistic stress test, covering all material sources of risk, including *IRRBB*, in combination with other risks (i.e. not IRRBB considered in isolation). This is in this section that other sources of risks should be considered, and not in the IRRBB-in-isolation framework: '*changes in secural changes in the market environment*' (which should be deleted in 30(c)), 'revision of dividend policy or decrease in business operations' (which should be deleted in 30(e)
- the articulation between paragraphs 28 and 29 should be clarified. It could be interpreted that diversification can be considered.

Question 5: Do you agree with the list of elements to be considered for the internal capital allocation in respect of IRRBB to earnings in paragraph 30? If not, please provide concrete suggestions and justify your answer.

As already mentioned, we believe that only elements linked to the risk of actual losses and not to the variability of earnings should be considered for the internal capital allocation in respect of IRRBB to earnings.

There are ambiguities in the internal capital requirement section. Some statements explicitly relate to loss risk, while some other statements seem to refer variability risk and to enterprise-wide stress tests (e.g. "reduction in dividend policy", "maintain business operations"). It is mentioned that these should be considered "capital buffer" for "reduced earnings in stress scenarios”, which does not make sense. In our opinion, internal capital should relate to loss risk, whereas variability risk should be taken into account in enterprise risk stress test. The link between IRRBB and the “dividend policy” should be avoided. This requirement is not appropriate. The revision of the dividend policy cannot be considered as losses. Payment of dividends are not directly correlated to the level of net interest income.

Governance

Question 6: Are the guidelines in section 4.3. regarding the governance sufficiently clear? If not, please provide concrete suggestions and justify your answer.

Paragraph 33

As to the governance, the draft Guidelines ask institutions to express their risk appetite for IRRBB in terms of the maximum acceptable short-term and long-term impact of fluctuating interest rates on both earnings and economic value, and to reflect all this into limits.

Given that an appropriate definition of the short-term and long-term horizons is not straightforward, and that, when assessing the impacts on earnings and on economic value, different time horizons are usually applied, we suggest deleting the reference to the short-term and long-term horizons.

Moreover, the requirements to express the risk appetite in terms of maximum acceptable impact of fluctuating interest rates is overly prescriptive.

This should be simplified such as '*the risk appetite statement for IRRBB should be expressed in terms of both earnings and economic value*'.

Finally, the prescription for credit institutions to *“determine their risk appetite in relation to each of [the] sub-types of IRRBB”* is neither relevant nor efficient. Indeed, the delineation between gap risk and the two other types of risks is not straightforward but mainly relies on expert judgment and arbitrary assumptions. This is clearly exemplified in the Annex I table which does not present any risk metric specific to either basis risk or option risk. Besides, distinguishing the risk appetite for each sub-type of IRRBB would make it unnecessarily difficult for executive committees and supervisory boards to assess and validate institutions’ risk appetite framework as RAFs would rely on too many technical assumptions. The EBF recommends deleting this requirement.

Paragraph 44 (f)

The instruments accounted for fair value, notably derivatives, are unduly stigmatized in the draft guideline. The consultative document requires considering them separately for defining risk appetite statement, and to define limits "*to control mark-to-market risks in instruments that are accounted for at market value*".

These instruments are part of the integral IRRBB position, and should be measured and monitored as integral part of it. The objective of separate measurement is unclear. This is in our view a fatal flaw of the draft guideline. We believe that isolating instruments accounted at fair value does not make sense. Derivatives should not be stigmatized without reason. The same applies to paragraph 67 (e).

Paragraph 53 (b)

It should be clarified that ***the requirements*** to '*be capable of fully and clearly recording all transactions made by the institution, taking into account their IRRBB characteristics*' (§53(b)) and to '*enable the institutions to fully measure, assess and monitor the contribution of individual transactions to their overall exposure*' (§53(e)) **apply at individual institution level, and do *not* apply at consolidated level**. That is to say that an entity in a Group should meet this requirement, but there is no requirement to have *all* individual *transactions* available at the consolidated level (typically at Head Office level).

Applying this requirement would be far too restrictive for all banks and particularly for large and internationally active banks. Each institution should be free to consider how to manage data on a line by line basis or an aggregated basis.

Paragraphs 53(c), 53(e) and 55

The combination of both paragraphs is confusing. Each and every institution should be free to consider its data on a line by line basis or on an aggregated basis.

Paragraph 73

This paragraph should give more specification on the scope of model validations. Model inputs, assumptions, modelling methodologies and outputs are too general. We would propose to focus on client behaviour models and to add an objective materiality criterion like the criterion for currencies in the supervisory outlier test.

Measurement

Question 7: Are the guidelines in section 4.4. regarding the measurement sufficiently clear? If not, please provide concrete suggestions and justify your answer.

Please refer to our comments above on basis risk.

Clarification is also needed with respect to the actual definition of "non-maturity deposits" (paragraph 106). Doubts arise since in the draft Guidelines it seems that "non-maturity deposits" are assumed to be deposits "without any specific repricing dates". In this respect, an explicit definition could be helpful and, above all, clarity would be welcomed about what should be intended as a "specific" repricing date.

Paragraph 83

This paragraph states that the SOT needs to be fully integrated within the internal *IRRBB* framework. While we agree, it should not drive hedging decisions or have any influence in how Risk Appetite is set or how *IRRBB* is capitalised. The SOT is a regulatory warning indicator and as such needs focus and governance, while not driving IRRBB management.

Paragraph 103

This paragraph says that measurement assumptions should be reviewed '*at least annually*', while it should be mentioned 'regularly', notably to be consistent with article 74 and 45 (c), and to be proportioned to the materiality of assumptions.

Paragraph 104

Are competitor's activities and the underlying environment to be taken into account in the models (which we see as a too high expectation) or is it sufficient to include them in stress tests?

Paragraph 105(c)

The requirement of "*a margin of conservatism should be used where there are uncertainties*" should be deleted. Indeed, it is not only not clear but it does not make economic sense since there is no pre-determined direction in which to be 'prudent'. There is no prudence in adopting a too short or too long duration for deposits, or too low / too high prepayment rate. IRRBB is a symmetrical risk (different from liquidity risk which is asymmetrical).

Paragraph 106(a)

The definition of "core" and "transient" balances on transaction accounts should be revised in order to offer more flexibility to credit institutions. Moreover, the current definition seems inconsistent with the definition of "stable/operational" and "less stable/non-operational" deposits applicable to liquidity requirements.

We suggest replacing the statement on identifying separate core balances by the following: '*Behavioural assumptions should take into account the stability of outstanding balances*'.

Question 8: Do you consider the comparison between EV metrics calculated using contractual terms for NMDs with the EV metrics calculated with behavioural modelled assumptions sensible and practical? Please justify your answer.

The comparison between EV metrics calculated using contractual terms for NMDs with the EV metrics calculated with behavioural modelled assumptions is of very limited benefits: we recommend that no such requirement applies.
For instance, when applied to demand deposits, it makes absolutely no sense to assume they would runoff overnight.

It is not clear what the information is going to be used for. Banks and supervisors would need be extremely careful with any interpretation of this metric and any conclusions. It would not provide any better insight of the actual risk and very limited insight into the amount of model risk.

The comparison would lead to a higher difference between both EV metrics in banks with a greater volume of NMDs modeled or with a longer maturity assumption, giving no more information about the soundness of that model.

From another point of view, a bank with a longer duration estimated would show a greater impact than another with a shorter duration (overestimated) only by the nature of its customer deposits, without providing any valuable information about the model.

There is already significant governance around the use of behavioural assumptions, including stress and scenario analysis. Contractual terms are significantly shorter, overnight when current accounts are considered, so this analysis only shows how much risk using the behavioural assumptions are generating. NMD's will most likely be a separate line item within the risk calculations, so can be easily identified. Isolating this number, without considering how this risk is hedged, might be misleading. We would advise not to disclose the results of such comparison. Instead, we suggest replacing this comparison e.g. by a non-disclosable sensitivity of EV metrics to a change in the behavioural modelled assumptions of NMDs by 0,1 year.

Supervisory outlier test

Question 9: Are the guidelines in section 4.5. regarding the supervisory outlier test sufficiently clear? If not, please provide concrete suggestions and justify your answer.

Paragraph 113 (b)

In our understanding, a bank should consider in-scope for this provision a "small trading book business" within the meaning of Article 94 CRR, if the bank uses the derogation allowed. If the proposed interpretation is correct, we would suggest clarifying that point (b) of paragraph 113 only applies to banks taking advantage of the derogation granted in Article 94 CRR. Otherwise, clarification is needed about the meaning of "small trading book business".

Paragraph 113 (f)

In order to align SOT to internal cash flows modelling, we propose to modify the text as follows: "(f) The cash flows from interest rate sensitive instruments should include any repayment of principal, any repricing of principal and any interest payments. *Institutions should be allowed to take into account adjustments to reflect expected future credit losses according to the banks' IMS;*".

Paragraph 113 (g)

In order to align SOT to internal calculation, we suggest modifying the paragraph as follows:
(g) "NPEs and their provisions should be treated as general interest rate sensitive instrumentsaccording to banks' IMS "

Paragraph 113 (k)

It should be clarified that the floor should be applied to the risk free curves and transposed consistently (keeping the basis between the different curves) to all the other curves. We suggest rephrasing the text as follows: "*A maturity-dependent post-shock interest rate floor to the risk free curves should be applied for each currency and curve starting with -150 basis points for immediate maturities. This floor should increase by 5 basis points per year, eventually reaching 0 % for maturities of 30 years and more. The impacts of the floor applied to the risk free curve should be consistently applied to the other curves*"

Paragraph 113 (m)

We believe it should be allowed to take into account gains in one currency / some currencies against losses in other currencies when stress testing IRRBB across all currencies, especially when such a gain has been generated from an IRRBB generated hedging strategy.

Paragraph 113 (n)

This paragraph prescribes one risk free rate per currency.

It should be clarified that the "appropriate general 'risk free' curve" refers to the discounting curve. Besides, it should be clarified that banks could still adopt a multi-curve in their IMS, to use different risk-free curves for discounting according to their IMS depending on the instruments (e.g. financial derivatives and cash instruments).

We suggest to amend the paragraph to read : "*at least one discounting risk free rate per currency according to the IMS*"

Paragraph 113(o)

The five years cap should only apply to "*non-maturing deposits*" and not to "*non-repricing deposits*" (see also remark on paragraph 106).

The current wording is confusing and we would appreciate confirmation from EBA that "a maximum average of five years" has to be intended as a cap to the average repricing date of all *non-maturity deposits* and not to the highest assumed repricing date.

It should be clarified that the cap relates to the maximum average repricing maturity dates (consistent with page 9 in the guidelines)

Question 10: Is the proportionality adequately reflected in the guidelines, in particular in relation to the transitional period for SREP category 3 and 4 institutions and the frequency of calculation for the additional outlier test under paragraph 112?

Although the guideline makes general comments on the proportionality principle it does not practically apply in several cases (e.g. reporting requirements, paragraph 63). We therefore recommend concrete provisions to avoid misunderstandings in the audit process.

We do not think that proportionality should only refer to less stringent reporting deadlines. Instead, proportionality should bring qualitative and quantitative relief, especially when the requested data does not deliver any significant value for the supervisor.

It should also be clarified if the guidelines apply at solo, at sub-consolidated or at the highest consolidated level. The European Banking industry supports the application of those requirements only at the highest level of consolidation of credit institutions and investment firms, not subject to the capital derogations as defined in Article 7 of Capital Requirement Regulation (EU) n° 575/2013. The new 15% threshold should only apply to non-large and internationally active banks after an impact study, in order to inform both the competent authorities and the industry on the impact of the implementation of this new BCBS criterion. Until now, the new threshold was not tested on the individual entity level, nor for smaller institutions.

Question 11: If relevant, do you manage interest rate risk arising from pension obligations and pension plans assets within the IRRBB framework or do you cover it within another risk category (e.g. within market risk separately from IRRBB, etc.)?

Pension obligations and pension plans assets do not depend on the management of the interest rate risk arising from the banking book but on the corporate risk structure of institutions.

For pension assets held within trust structures, governed by a separate board of trustees and monitored under a separate section of the ICAAP, the incorporation of such metrics within the broad IRRBB metrics is not appropriate.

Question 12: Which treatment of commercial margins cash flows do you consider conceptually most correct in EV metric, when discounting with risk free rate curve: a) including commercial margins cash flows or b) excluding commercial margins cash flows? Please justify your answer.

We believe that EVE calculation has to be aligned with banks' risk frameworks and businesses, which will inevitably differ. There are frameworks that require including full cash-flows in the EVE calculation and these could either be discounted with proprietary curves or adjusted for expected credit losses and funding costs. Some banks will consider margins part of their interest rate risk, may want to reflect dynamic assumptions and may require a more sophisticated approach than stripping margins from EVE calculation.

Other banks prefer the exclusion of commercial margin from the EV metric, when discounting with risk free rate curve to show the IRRBB scenarios that the institution is exposed to and any large Gap mismatches.

Question 13: Are your internal systems flexible enough to exclude margins for the purpose of calculating EV measures for the supervisory outlier test? If not, what would be the cost to adapt your systems (high, medium, low)? Please elaborate your answer.

The feedback received is mixed. While some banks indicated that systems are flexible enough to exclude margins, they also stated that the adaptation is costly. Until now, without clear management framework of commercial margin, every credit institution has developed its internal system. The cost will therefore depend on every institution. Some EV systems tend to be legacy in nature, thus inflexible when compared to more modern EaR IT systems. In general, it would take significant system development to adapt for SOT purposes.

Question 14: Do you consider the level of the proposed linear lower bound as described in paragraph 113 (k) appropriate? If not, please provide concrete suggestions and justify your answer.

We support to establish a minimum lower bound to negative interest rates as we believe that Interest rates (IR) below zero are irrational and correspond to an exceptional situation motivated by the action of the Central Banks. Accordingly, IR show a natural reluctance to enter extensively in negative levels.
Conceptually, any lower bound will potentially cause asymmetry between upward and downward shocks. We understand the preference of EBA to propose a lower bound but the level of this bound is fairly subjective considering the lack of historical data.

As European Banks have been managing the SOT with a range of regulatory floors, with many jurisdictions clustered around a 0%, the adoption of 113 (k) could present day one issues. A phasing in approach could be considered. Also, the term structure of the floor level (annual increase of 5 bps) will likely mean a significant burden in the operative, complicating the metrics calculation, and preliminary analysis show little impact in the outcomes compared to a flat floor.

Although we recognize that any level stated may be subjective due to the lack of historical data, we consider the proposed minimum level of negative interest rates to be excessively conservative for a Pillar II requirement. An analysis has been performed on the historic volatility of interest rates, which shows that even for the current very low levels, it is highly improbable for rates to go below -100bps. The analysis has been performed on EUR and GBP, using the 6 month curve for the earlier and 3 month curve for the later. Over a 5 year series of returns (computed quarterly and semi-annually) the 1%-ile of the return distribution (representing the most adverse down movements in the curves) was computed. For each tenor of the curve, this extreme down movement was subtracted from the current level of the rate. The minimum level reached (i.e maximum floor) across all tenors was: i) For EUR: -0.90% (quarterly results) and -0.99% (semi-annual returns); and ii) For GBP: -0.69% (quarterly results) and -0.87% (semi-annual returns). This evidences that a) -1.50% is extremely conservative, and b) a currency dependant floor may be considered.

While we think that regulators should be in a position to determine the most appropriate lower bound for currencies under their jurisdictions, internationally active banks are faced with different prescribed lower bounds from different regulators resulting in loss of comparability of disclosures across geographies. This also would require devoting scarce IT resources to run additional regulatory scenarios to satisfy many different lower bound requirements.

We would therefore like to propose the possibility of regulators authorizing different floors for currencies out of their jurisdictions when the boundary is defined by a foreign regulator. We think that this measure will increase comparability across the industry and efficiency in banks reporting processes. Besides, in the last years, the use of a multi-curve framework has become an industry sound practice (e.g. OIS, LIBOR 1 month, LIBOR 3 months, LIBOR 6 months and LIBOR 12 months are usually associated to different curves). When considering the same regulatory floor for multiple yield curves in a single currency, the basis spreads between curves might become zero, which reveals a flaw in the proposed methodology. Hence, we suggest first applying the floor to the risk-free interest rate curve for each currency, and then constructing the rest of the curves for the same currency preserving the current basis spread.

Finally, although we agree that there may be some merits in implementation of a non-parallel floor this may be subject to IT constraints depending on the functionality offered by different ALM software solutions. We would like to propose the possibility of setting a parallel floor where this approach does not lead to material differences in the EVE results.

Question 15: Do you consider the minimum threshold for material currencies included into the supervisory outlier test (5% for individual currency and minimum 90% of the total non-trading book assets or liabilities) sufficient to measure IRRBB in term of EVE? If not, please provide concrete suggestions and justify your answer.

BCBS standard n°368 establishes a 5% threshold over total assets or liabilities in order to properly measure the total banking book risk. The Guidelines add the requirement of covering a minimum 90% of the total banking book.

We consider that a minimum materiality threshold of 5% for individual currencies and 90% for the total is adequate and aligned with the common practices. However, we deem that an exception should be made in the case that there is an aggregated exposure over 10% which is very fragmented among many currencies with very low materiality (i.e. <2%).

In order to properly address this situation, we suggest maintaining the Basel threshold, or complete the Guidelines with an exception in the case that there is an aggregated exposure over 10% which is very fragmented among many currencies with very low materiality (i.e. <2%).

Question 16: When aggregating changes to EVE in the supervisory outlier test, does the disregarding of positive changes to EVE have a material impact on the calculation of the supervisory outlier test?

This strongly depends on the balance sheet composition of the institution. Disregarding positive changes could be significant if such positive changes are generated from hedging activities.

Also, the currency risk aggregation methodology proposed in the Guidelines is extremely conservative, as it does not recognize the benefits of diversification and excludes totally the compensation between gains and losses. We consider this method excessively simplistic and discriminatory for entities with diversified portfolios and risk profiles distributed among several currencies.

When analysing historical behaviour of currency diversified portfolios, the results show that the worst historical losses of the portfolio are far beneath the simple aggregation of the worst impacts in each currency, which proves the benefits of diversification.

Besides, as far as the historical correlation among rates in different currencies is not zero, results indicate existence of a compensation between positive and negative impacts. The size of the mitigating effect will depend on the correlation and the exposure profile in each particular currency.

We find the proposal too simplistic and methodologically flawed. While perfect correlation is assumed among negative impacts (independently of the degree of relationship among the currencies involved), there is absolutely no recognition of positive impacts arising from different risk profiles in several currencies. We believe this goes against the spirit of the Guidelines, where a high level of accuracy in measuring IRRBB is expected, especially for the most sophisticated entities. Although IRRBB by currency may be correctly measured, the final consolidated risk figure will be noticeably inaccurate as impacts are merely added without taking into account correlation effects.

All in all, the EBF recommends allowing banks to use their own approach for currency aggregation.