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EACB comments on
EBA Draft Guidelines issued on the basis of Article 84(6) of CRD 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)

General comments

The EACB welcomes the opportunity to comment on the EBA revisions to the Guidelines on Interest Rate Risk in the Banking Book (IRRBB) and Credit Spread Risk in the Banking Book (CSRBB).

We appreciate the EBA's aim to ensure that the various elements of the revised framework (revised IRRBB and CSRBB GLs, RTS on SOTs, RTS on standardized and simplified standardized approach) can apply consistently in an aligned timeline. Considering the wide range of items covered in the GLs, we believe that for the overall alignment of application dates, a timeline of 12 months – after the publication in the Official Journal of the technical standards – is necessary. Indeed, we encourage EBA to ensure that the time between the publication of the final regulatory products and their application is sufficient to allow institutions to adjust where needed and we recommend keeping a proportionate approach throughout the framework.

Looking at the Guidelines specifically, we understand the EBA's objective to specify in more detail the requirements for the internal management of interest rate risks in the banking book and give more guidance on the treatment of credit spread risks. However, regulatory requirements must not lead to a situation where the individual position of the banks and the resulting necessary adjustments to the risk measurement methods can no longer be considered. In particular, policy design should not lead to a scenario where banks neglect economic and bank-specific analyses and considerations because they become less relevant in light of the regulatory framework. This could determine a loss of competence in the banks which would have long-term, negative effects and eventually lead to inadequate risk capture. This must also be considered by supervisors.

We welcome the EBA's efforts to uphold the principle of proportionality in the revised draft Guidelines. We understand that section 4.1.2 and para. 41(c) of the consultation paper imply that not all requirements would be directly mandatory for small and less complex institutions. We recommend making this more explicit, in order for supervisors to duly take this into account when assessing application of the requirements.

Technical comments

➢ ***Expanded definition of net interest income (NII)***

We are critical of the extension of the definition of net interest income to include various valuation effects. First, the changes in the present value can only be captured appropriately in the EVE method. They are fundamentally different from the P&L valuation effects following price movements of the valued products since, in contrast to the EVE approach, valuation or accounting options in the P&L context may distort the actual price movements. Second, the definition is inconsistent with the accounting usage of the same word, which is likely to lead to misunderstandings that could be avoided. Third, the explanations currently provided are difficult to interpret for non-IFRS banks (e.g. "market value changes of instruments shown in the profit and loss account or directly in equity"). Finally, extensive consideration and simulation can entail effort that seem

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disproportionate to the benefits, especially for small institutions. For instance, currently German HGB-specific effects are not considered in the regulatory framework, which potentially leads to the need to model effects that do not represent a relevant risk at this point.

We therefore recommend that the risk metric including valuation effects is summarized under the term "earnings" or total income, that a materiality limit is established for the consideration and limitation of these effects, and that requirements also be presented in such a way that they are meaningful for institutions that do not prepare their accounts in accordance with IFRS.

- ***Economic long-term risk***

We would like to point out that the run-off balance sheet assumption (para. 102), which is described in the consultation paper as a "limitation" of the EVE simulation, is the essential element of the present-value risk perspective. In contrast, the periodic view includes new business, but not – like the present value perspective – the entirety of future cash flows. For this reason, both perspectives are considered in risk management.

Additional analyses of the EVE metric including new business are not relevant for small and less complex institutions and represent a disproportionate effort. Considering the proportionality principle, we do not consider these requirements to be meaningful and advise against including them in the final regulatory products and supervisory practice. We also recommend to clarify the requirements and the economic background regarding para. 103.

- ***Criteria for non-satisfactory internal methods and procedures of the IRRBB***

We welcome the fact that the proportionality principle has been taken into account in the identification of non-satisfactory methods and procedures. Some of the explicit requirements, such as the consideration of basis and option risks and the extensive requirements for the review as well as validation of the internal models would represent a disproportionate effort. An example of this is the requirement under para. 112(h) to isolate the effects from behavioural assumptions. The realisation of contractual maturities is a strong behavioural assumption itself and is not suitable as a reference point. The requirement from para. 109(b) regarding the analysis of elasticities in behavioural options is also not suitable for small institutions, as pricing effects from elasticities can only be mapped by means of complex derivatives (For example, a deposit of € 100 the interest rate of which is linked to a current interest rate at 70% is no longer worth € 100 in the event of an interest rate adjustment. This problem can be circumvented using moving averages).

We would like to point out that appropriate simplifications can also be made here according to the materiality of the risk and the proportionate consideration of the type of bank. We encourage supervisors to take this into account. Furthermore, given the intrinsic idiosyncratic nature of IRRBB the standardized models proposed can hardly reflect the individual risk situation of individual banks, therefore delivering inadequate results. Under no circumstance the standardized approach should be used as a benchmark or for other comparative purposes – we further develop this in our answer to the RTS on standardized approaches.

- ***CSRBB***

While we disagree with the general approach to include all positions in CSRBB as baseline assumption, we welcome the possibility to exclude positions that are not affected by market credit spreads from the risk assessment. This is particularly important in the case of local banks, with a high proportion of retail customers, for which no credit spread effects can be observed or no corresponding market data is available, e.g. for customer loans and bonded loans. It seems disproportionate however that each bank should individually show that its retail business is not dependent on credit spread movements. This is particularly true for small and non-complex banks as for these institutions the CSRBB requirements would be complex to implement as a whole.

We suggest explicitly allowing exceptions. For example, we consider a materiality limit for credit spread effects to be reasonable. Furthermore, there should be the possibility to exclude certain positions from the risk assessment, provided it can be shown that the corresponding risks are already assessed and managed elsewhere (e.g. within combined credit risk and credit spread risk models). An example of this is 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. In our view, it is mainly relevant that CSRBB is measured and managed according to concrete qualitative requirements. The question of whether risk measurement and management are carried out in isolated or in an integrated manner should not be relevant. The purpose of these exceptions is to avoid undue efforts. The introduction of additional metrics, control procedures and monitoring processes lead to significant additional effort for banks, and especially SNCIs, which are already facing significant challenges.

Answers to selected questions

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.

We strongly disagree with the choice to introduce the five-year cap. Disallowing the modelling of NMDs severely constrains the actual IRRBB risk management of institutions, this would lead not only to results that are too conservative but also to potential inconsistencies, particularly where e.g. hedging of the positions stretches over a say 6 years horizon. In such cases it would in fact not be prudent to have the 5 years cap. We also strongly disagree with the exclusion of non-maturity deposits from financial customers from NMD. This prevents the models from mirroring reality and is not in line with BCBS 368. Moreover, the wording is not consistent and mentions a cap on the maturity itself rather than the average.

We also highlight the following:

- The explanatory box clarifies that the 5-year cap applies to the full amount of NMDs – as opposed to just core deposits. Provided that we disagree with the cap, as noted above, such clarifications should be also included in the regulatory text.
- While it is clear from the explanatory box that the 5-year cap applies to the combined volume of core and non-core deposits, it remains somewhat ambiguous if the 5-year cap would apply to
  - the aggregate NMD portfolio, or
  - to portfolios individually.

  This should be clarified in the regulatory text. Moreover, we observe that it is not uncommon for retail transactional deposits portfolios to have modelled average maturities beyond 5 years – in line with the nature of this product. Hence, the 5-year cap apply could at most be applied to the aggregate portfolio of modelled non-maturing deposits and not on each portfolio individually. Alternatively, at least a higher cap should be considered for retail transactional deposits.

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

The criteria are comprehensive. However, we suggest adding further wording so that in the supervisory evaluation process authorities can duly consider the relevant proportionality aspects and allow simplifications and adjustments in line with the underlying, bank-specific risk materiality. Examples where such proportionality should be applied, are the assessment of elasticities in 109(b) which small, non-complex institutions are mostly not able to perform and the isolation of behavioral effects under 112(h), which is of very limited informative value.

We also suggest to indicate that, where a supervisor is of the opinion that an institution does not satisfactorily comply with all elements required for internal models, in particular 119b, the supervisor should start a dialogue with the institutions to restore compliance rather than immediately imposing the (S)SA.

Besides, we propose to streamline the text in some points and to avoid duplications (e.g. 154 vs 155 and 146 vs 149).

For the inclusion of fair value changes in the definition of the NII we see challenges arising from the diverging accounting definition of NII (as it is for example also reported in FINREP) in comparison to the NII definition for IRRBB purposes. We also point to the fact that the complexity for small institutions to measure those risks significantly increases as internal risk measurement and steering is often based on the narrow NII definition. Furthermore, the CRR and CRD mention NII in contrast to an Earnings perspective named as NII, which is being proposed by the EBA. We therefore strongly recommend that fair value effects continue to be considered under an earnings metric and that a materiality threshold can be established for the consideration and limitation of these effects.

Moreover, to cater for banks that are not accounting according to IFRS (e.g. in Germany, Austria), the requirements should be presented in such a way that they are meaningful for all institutions and the wording should be adjusted accordingly.

We agree with the fact that IRRBB from an NII perspective is an important risk that needs to be measured and reported. However, given that NII is part of the normative perspective, the individual limitation of this specific risk is not in line with the general normative assumptions and underlying management actions. Like other factors in the normative perspective, NII should only be assessed periodically under defined overarching scenarios and analyzed in the context of the entire normative requirement. We would therefore ask the EBA to align the definition of limits in the normative context with the new ICAAP requirements to allow banks to streamline their efforts and to prevent diverging steering implications.

Finally, we ask the regulator to specify in the Guidelines that banks cannot solely rely on the (simplified) standardized approaches but need internal measurement systems to fully reflect their bank-specific behavior. Standardized approaches for IRRBB are no alternative to adequate internal risk management and should not be used as a benchmark. We emphasize that there should be no incentive to neglect building and retaining internal competences in the context of interest rate risk management.

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?

There is currently no industry standard on how to measure CSRBB. On the contrary, the existing approaches differ strongly. Hence, no industry standard should be "enforced" by the EBA. The specifications should be "modeling neutral", which is not the case. For example, there are credit risk models that are extended to include components for measuring CSRBB, which allow integrated measurement of spread changes based on changes of creditworthiness as well as changes in the market price for credit spreads. Especially with such integrated models, the proposed approach can quickly lead to double counting, which must be avoided. The existing models are all well understood and proven, and their use should continue to be possible.

Overall, guidance on instruments – other than fair valued ones – to be included in the calculation of CSRBB is unclear and may be interpreted differently by the banks. CSRBB is defined as relating to changes of market credit and market liquidity risk, yet the definition of market is undefined. A usual interpretation would be the one referring to instruments with a deep, liquid and active secondary market, yet this is not specifically stated.

The scope includes the liability side of the balance sheet but the GL does not provide guidance on potential netting from similar instruments on both sides of the balance sheet. Further, the consultation states that a deterioration of an institution's credit quality should not have any positive impact on the credit spread risk measure. Notwithstanding idiosyncratic risk, some clarification is needed on whether a deterioration in own credit due to changes in general market credit spreads is in scope.

According to para. 157, idiosyncratic spread components can only be included in the CSRBB measurement if evidence is provided that the inclusion is conservative. The obligation to provide evidence should be deleted, since, depending on the reporting date considered, an inclusion can lead to an increase in risk at one time and a reduction in risk at another, due to the diversification effects that may be present in the case of an inclusion. Since any inclusion of additional components of the total credit spread risk tends to increase double counting, it should be considered conservative and allowed per se without the requirement for evidence. In contrast, a precise measurement of the individual components of credit spread risk (market spread, liquidity spread, separate consideration of idiosyncratic spread) may be theoretically desirable but it is not possible in practice. This corresponds with the associated explanation box (on page 46). Even if the spread components were to be separated, it is still questionable whether it would offer any added value at all and lead to meaningful steering input in the institution. For example, the default premium could already be included in the credit risk and the liquidity premium could, if necessary, be included in the institution's liquidity risk. Expected rating changes, i.e. expected migrations to other rating classes, can in turn affect the default premium and, if applicable, the liquidity premium.

Usually, credit spread data is sector and/or country specific and there is no general market credit spread curve for each rating class. If the final version still requires the use of a general curve, clarification is needed on how the general curve can be obtained. When considering credit spread risk, institution-specific circumstances (portfolio composition, design of internal systems, availability of reference data, etc.) should be taken into account. The specific design including integrated or isolated measurement should be up to the banks. For example, the analysis of spread components clustered by currency proposed in paragraph 123 is not appropriate in every case; on the other hand, other clusters (e.g., by rating class or sector or even a more granular, issuer-specific mapping) may become relevant. Here, it should be up to the institutions to choose an adequate type of clustering. In our view, this is the only way to achieve meaningful results and to derive sensible steering input in the institutions.

Backtesting does not always deliver meaningful results or is not possible at all. For example, for a customer loan - e.g. a loan to corner shop – there is no market where the actual result can be observed (see note 147). It remains unclear which value should be backtested and which meaningful implications (management input) should be derived from this theoretical exercise.

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

The EBA has widened the scope for the measurement and monitoring of CSRBB, which includes not only fair valued instruments but also other, non fair valued, instruments that are not part of existing guidance on CSRBB. The scope states that no instruments in the banking book should be excluded from the scope of CSRBB (e.g. off balance sheet loan commitments). However, by definition, the scope is limited to those instruments with exposure to market credit and market liquidity spread risk and observable credit spread activity. The definition of the perimeter should therefore be explicitly reduced to this. Further, the GLs do not provide clear guidance on the instruments to be included for CSRBB measurement. This will require further clarification for proper implementation.

The scope includes the liability side of the balance sheet but the GLs do not provide guidance on potential netting from similar instruments on both sides of the balance sheet. Further, the consultation states that the deterioration of an institution's credit quality should not positively impact the credit spread risk measure.

Moreover, the inclusion of idiosyncratic elements for CSRBB calculation is not very clear as in 5.1.3 it is mentioned as preferred option idiosyncratic elements should not be included for CSRBB measure. Only market and related liquidity elements should conform CSRBB definition. In practice, we see considerable technical difficulties in isolating forward-looking market expectations regarding the development of idiosyncratic credit risk from observable credit spreads.

We also recommend explicitly allowing the introduction of threshold to ensure that small banks, and more generally banks with immaterial risk exposure, can be excluded from the calculation process. Furthermore, it should be possible to exclude certain positions from the risk assessment if it can be shown that the corresponding risks are already assessed and managed elsewhere (e.g. within combined credit risk and credit spread risk models). An example of this is 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. Furthermore, while CSRBB must be measured and steered, the specific design including integrated or isolated measurement should be up to the banks. We suggest reflecting this aspect in the final text.

We support the approach to focus the CSRBB on assets at fair value and we agree that there might be particular assets at book value to be included into the CSRBB framework. However, we do not consider generally including assets at book value and requiring banks to demonstrate exceptions a pragmatic approach. Instead, we would welcome if assets at book value were excluded from the CSRBB in the first place and if cases in which assets at book value might be exposed to credit spread risk could be clarified in the Guidelines.

Market prices are not available for traditional customer lending business. This is therefore outside the scope of application as defined in para. 7. For example, co-operative banks across various Member States fund a large number of small and medium-sized enterprises (e.g. corner shops), for which no market prices are available and therefore no credit spreads can be determined. The same applies to private mortgages. Where meaningful market information is available (e.g. corporate bond portfolio), such positions should be included in the CRSBB measurement. Specifically, this applies to transactions for which credit spreads are relevant, i.e. securities in particular.

Hence, we advocate a narrower interpretation of CSRBB, which we believe is also in line with the Basel rules. Based on the sensitivity of the position to credit spread risk, fair value positions would generally be included. However, positions for which changes in the balance sheet cannot be observed, e.g., loans accounted for at amortized cost, would generally be excluded from the CSRBB analysis, as they do not (materially) affect the credit spread risk and would also incur immense expenses.

In line with our understanding of the definition of CSRBB (see answer to Question 3), only positions for which meaningful market information is available should be included in the measurement of CSRBB. Reference prices are not sufficient, position-specific prices have to be available. This includes marketability and a certain minimum market liquidity. Prices from secondary markets, on the other hand, are not suitable for an adequate measurement of CSRBB (e.g. bonds traded on secondary markets with only issuer spreads available would also have to be excluded). As a result, only liquid fair value positions in the banking book should be included in the measurement. In our view, this is the only way to achieve an appropriate management effect in the institution.

In particular, we reject the requirement in para. 124 that institutions should not be allowed to exclude certain positions ex ante but must provide detailed documented evidence of an absence of sensitivity to credit spread risk each time a group of similar positions is excluded. In the examples given for certain product types, it would make more sense to generally assume that CSRBB is not material (negative lists at least at national level).

In special cases and depending on the respective business model, the competent authority could further review the respective transactions regarding the relevance of CSRBB.

Furthermore, pragmatic procedures should be envisaged to allow institutions to exclude non-material items from the scope on an individual basis. Sensitivity analyses should also be allowed to be carried out on a qualitative basis, e.g. for the exclusion of certain derivatives (if not on the negative list).

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 distinction is clear.

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