

## **GBIC comments on the EBA's consultation papers on IRRBB**

Register of Interest Representatives  
Identification number in the register: 52646912360-95

Contact:

Stefan Götz	Christian Saß
Director	Associate
Telephone: +49 30 1663-2170	Telephone: +49 30 1663-2110
E-mail: stefan.goetz@bdb.de	christian.sass@bdb.de

Berlin, 28 March 2022

The **German Banking Industry Committee** is the joint committee operated by the central associations of the German banking industry. These associations are the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), for the cooperative banks, the Bundesverband deutscher Banken (BdB), for the private commercial banks, the Bundesverband Öffentlicher Banken Deutschlands (VÖB), for the public banks, the Deutscher Sparkassen- und Giroverband (DSGV), for the savings banks finance group, and the Verband deutscher Pfandbriefbanken (vdp), for the Pfandbrief banks. Collectively,

Coordinator:  
Association of German Banks  
Burgstraße 28 | 10178 Berlin | Germany  
Telephone: +49 30 1663-0  
[www.die-deutsche-kreditwirtschaft.de](http://www.die-deutsche-kreditwirtschaft.de)  
[www.german-banking-industry.org](http://www.german-banking-industry.org)

## Comments

### General comments on all three consultation papers

The consultation papers are based on mandates in Articles 84 and 98 of the CRD and augment to an unprecedented extent the existing European regulatory framework for interest rate and credit spread risk in the banking book. They will thus have a very significant influence on how European institutions identify, measure and manage these two risk categories. It is therefore highly important that the requirements are introduced with care, in compliance with the proportionality principle and with sufficiently long implementation periods.

From an overarching perspective, it is especially important with the structure of the German banking industry in mind to ensure that all "subcomponents" of the new regulatory framework are designed with a sense of proportion. This is essential to avoid overburdening smaller institutions. German less significant institutions (LSIs) account for over 50 per cent of all banks in the euro area. In consequence, proportionality considerations have a special significance for the German banking industry. The proportionality concept plays a particularly strong role in Pillar 2, which requires the measurement and management of risks to be proportional to the size, complexity and risk profile of positions in the banking book. As a result, big banks with complex business may measure and manage their interest rate risks extremely frequently, while smaller institutions with less complex business may do so at longer intervals (such as monthly or quarterly).

It may be assumed that not all institutions as yet meet the new requirements, some of which are highly ambitious. It is therefore vital to allow adequate transitional periods. In principle, a transitional period of at least two years from the entry into force of the new regulatory technical standards and guidelines will be needed if they are to be implemented appropriately. To ensure consistent application, moreover, the guidelines should be implemented at the same time as both sets of regulatory technical standards.

Institutions generally measure and manage interest rate risk in the banking book (IRRBB) using both perspectives (EVE, economic value of equity, and NII, net interest income). For the EVE perspective, value-at-risk models are normally used while simulation or scenario models are often used for the NII perspective. But many institutions define a primary steering circle (EVE or NII), which is activated in the event of conflicts in risk management. This may be the present-value perspective, which focuses on changes in the economic value, or the earnings-oriented perspective, which focuses on changes in net interest income. If further interest rate risks arise on a significant scale in the non-primary perspective, these would also have an impact on the primary perspective (see, for example, German MaRisk, BTR 2.3 para 6). It is basically up to each individual institution to decide which methods it will use to measure and manage IRRBB. The ability to make one perspective the primary one should be retained, bearing in mind that the other perspective will also be taken into account as a parameter.

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### Draft RTS on supervisory outlier tests (SOTs)

#### Question 1:

*Do respondents find the common modelling and parametric assumptions for the purpose of the EVE SOT and the NII SOT in Articles 4 and 5 clear enough and operationally manageable? Specifically, the EBA is seeking comments on the recalibrated lower bound for post-shock IR levels in the EVE SOT and NII SOT as well as on the use of a one-year time horizon and a constant balance sheet with current commercial margins for new business for the NII SOT. Respondents are also kindly requested to express whether they find an inclusion of market value changes in the calculation of the NII SOT clear enough.*

One-year time horizon and constant balance sheet assumption:

In principle, we support these requirements in the interests of comparability and believe they will also simplify calculations. In accordance with the CRD requirement (cf. Article 98(5a)(c)(iii) of CRD V), the period over which future NII will be measured must also be specified. The ECB opted for a 12-month period for the purpose of its short-term exercise (STE). We support this decision on the condition that institutions only have to carry out the calculation for complete calendar years.

It should also be borne in mind that it is not possible for certain business models (e.g. German building and loan associations, development of the building savings pool, entitlement to loan drawdowns from a building savings contract) to comply with the constant balance sheet assumption in a way that makes sense. In such cases, the requirement should be applied less strictly and on a best-effort basis. Alternatively, such business models could be permitted to opt for a dynamic balance sheet assumption.

In addition, we see a danger of the consideration and replacement of embedded termination rights and swaptions potentially generating disproportionate costs under the constant balance sheet assumption. Given the lack of relevance and materiality of these positions, relief should be considered so that costs do not outweigh benefits. It might make good sense to omit them from the NII simulation or at least allow the use of a bank's internal model.

NII definition:

- To begin with, the additional consideration of the valuation result will lead to increased complexity and less comparability.
  - Write-downs and write-ups depend on national GAAP or IFRS and on the options exercised by institutions.
  - For banks that do not use IFRS, some of the explanations will be difficult to interpret (e. g. "market value changes of instruments shown in the profit and loss account or directly in equity").
  - The NII definition is inconsistent with that for the purposes of FINREP, where the amount of realised NII continues to be the difference between interest income and interest

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expense. This discrepancy and potential for confusion is problematic, in our view, especially when disclosing risk measures to the general public.

- It can result in arbitrarily high limit utilisation even if the NII risk is low in absolute terms (small denominator problem).
  - It connects unrelated items (the reason for administrative costs may be totally unrelated to NII exposure) and creates volatility and dependency in NII limit utilisation on non-interest rate items.
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- In addition, use of the broader definition will entail disproportionate time and effort. It requires the interest-induced valuation result to be isolated from other valuation corrections. A range of assumptions (e. g. about exchange rates, interest rate volatility, etc.) are needed to do so. This unnecessarily increases complexity and creates additional work without generating any meaningful added value.
  - For instance, differentiating between interest-related and non-interest-related net commission income generates a disproportionate operational burden. The inclusion of interest-dependent commission – especially if there is a strong focus on financing through retail deposits – requires complex analysis of the interest rate sensitivity and transmission to customers in different interest rate shock scenarios. At the same time, the interest-related portion of net commission income is generally quite small compared to an institution’s total interest rate risk, so there is no justification for the massive time and effort required.
  - Under German law, moreover, institutions without a trading book, for example, would have to value the liquidity reserve at fair value, while many other items are valued at amortised cost when performing the same check of whether provisions need to be set up in accordance with BFA 3<sup>1</sup> due to a lack of fair values at banking book level. The valuation of pension provisions under German GAAP depends on the interest rate level without fair value changes having any real direct influence on the calculation of profit and loss under German GAAP. As things stand, the regulatory framework for IRRBB takes no account of German GAAP-specific effects. This may result in the broader NII definition requiring banks to model effects that do not represent a relevant risk.
  - Last but not least, the inclusion of valuation effects in the NII is not appropriate from an economic point of view. Changes in present value can only be captured appropriately using the EVE method. They are fundamentally different from the P&L valuation effects following price movements of the valued products since, unlike under the EVE approach, valuation or accounting options in the P&L context may distort the actual price movements.
  - This would, for instance, be the case if securities are held for the purpose of hedging interest rate risk that arises from liabilities recognised at amortised cost. Using the EVE method, the change in value of both “sides” is recorded, while a distorted picture would arise under the NII method due to the inclusion only of the change in the value of the securities.

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<sup>1</sup> Announcement 3 of the Banking Technical Committee (Bankenfachausschuss) of the Institute of Public Auditors in Germany (Institut der Wirtschaftsprüfer in Deutschland, IDW)

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- The information content of valuation effects is therefore often lower than that of changes in present value. Consequently, an assessment of the change in the present value should continue to be based on the EVE approach while, at the same time, the NII method should be restricted to NII. On no account should the EVE and NII methods be combined.

### *Question 2:*

*Do respondents have any comment related to these two metrics for the specification and the calibration of the test statistic for the large decline in Article 6 for the purpose of NII SOT? Specifically, do respondents find the inclusion of administrative expenses in metric 2 clear enough? Do respondents have any comment on the example on currency aggregation for metric 1 and metric 2?*

The main basis for assessing the suitability of a benchmark should be the extent to which the metric can be used to help answer the question of whether the strength and stability of the earnings stream and the level of income are sufficient to generate and maintain normal business operations (Basel Standard para 91). We believe the advantages of the capital-based metric 1 clearly outweigh metric 2, especially taking into account the suitability criterion cited above. We see the advantages and disadvantages of the two options as follows:

### Metric 1 is

- simple to implement and keep up to date (no updating of an alpha factor as in option B),
- structurally similar to the metric in the EVE SOT, thus easier to understand, more transparent and with results that are easier to communicate,
- comparable even across different business models and cost structures (in contrast to option B, which would only allow peer group comparison),
- not dependent on the accounting standards used (unlike option B),
- more consistent over time since a change in the alpha factor (e. g. following a restructuring) will not, as in option B, possibly trigger a transition from non-outlier to outlier status,
- better suited to comprehensively reflect the ability of institutions to use their capital to absorb interest rate risks that arise.

### Metric 2

- A major disadvantage of option B, as we see it, is that it cannot normally be assumed that NII-related expenses are proportional to total expenses.
- Option B requires the alpha factor to be regularly updated; the effects of these updates are difficult to forecast, however, and will thus create an “uncertainty factor”.
- Option B is inconsistent by virtue of its very design as forecast revenues are set against historical costs. We have particular reservations about this approach because it mixes different periods, some of which will possibly contain one-off accounting effects. A combination may set risk management incentives based on past accounting effects that have no economic significance.

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- Option B may thus generate implausibilities in the context of restructuring and other structural changes.
- The consideration of FINREP data is operationally challenging, especially when it comes to reports submitted after the annual financial statements have been approved.
- Moreover, an interest rate risk metric should assess interest rate risk and not the bank's entire business model.
- In our view, the inclusion of administrative expenses in option B for the metric of a "large decline" in NII will potentially lead to less transparency and to problems in comparing the resulting metrics of banks, especially if they have different business models.
- We would like to point out that this combines the effects of changes in the interest rate risk positions of institutions with effects of expenses and income positions that go beyond net interest income and will significantly increase the complexity of the NII metric. As a result, it will be difficult to maintain a consistent view of the interest rate risk of institutions due to differences in their business models and to compare the development of interest rate risks over time.
- In addition, the definition of  $\alpha$  in option B refers to FINREP positions which banks preparing German GAAP accounts do not have available in this form ( $NII_{hist}$  with fair value changes, gains/losses). Since there is no direct equivalent in every accounting regime, the calibration of outliers, which is already based on a very small sample at present, cannot be applied here.

### *Question 3:*

*Do respondents consider that all the necessary aspects have been covered in the draft regulatory standard? Do respondents find the provisions clear enough or would any additional clarification be needed on any aspect?*

Regulatory "one-size-fits all" standard metrics for identifying outlier institutions will inevitably have methodological weaknesses and are therefore not a suitable means of determining a bank's individual risk situation.

For this reason, fulfilling at least one of the two outlier criteria set out in Article 98(5) of the CRD should not automatically trigger the imposition of capital surcharges by supervisors. The criteria should only be seen as indicators of a need for supervisors to monitor the institution more closely. This should be followed by a review of the institution in question and further investigation. Supervisors should begin by using all the information available to them and only then, in a second step, carry out further investigations with the involvement of the institution. The institution must be given an opportunity to comment, and it should have sufficient time to remedy any shortcomings that may exist. We would ask the EBA to add wording to this effect.

We are also opposed to the requirement in para 6 on page 5 and para 85 of the draft guidelines, which says that the SOT should be fully integrated into the internal framework for measuring and managing IRRBB and used as a complementary tool. This may set undesirable risk management incentives (e. g. to engage in hedging activities that make little sense). For

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internal management purposes, it makes sense to treat SOT results merely as a secondary indicator.

With respect to the calibration, we would like to stress that the sample used is too small for a decision of this importance. What is more, it is dependent on the interest rate environment and therefore clearly too conservative as we are currently in one of the extreme situations that are supposed to be reflected in shock scenarios. The calibration should therefore be reviewed after the first reports have been made. Moreover, using a snapshot as at a specific date to calibrate "outlier thresholds" based on observed variation across banks will not yield any information on potentially excessive NII risk. The methodology should be modified to make more economic sense.

In addition, it should be clarified how the baseline global interest rate shock parameters have been determined and why they are deemed appropriate from a regulatory perspective.

It should also be clarified why the scenarios defined in ANNEX 1 are appropriate given that they were calibrated on the basis of a time series from 2000 to 2015, when there was a large decrease in interest rates.

Clarification is needed in Article 1(3) that the currency-specific scenarios do not have to be applied to all currencies accounting for less than 5% of the non-trading book assets once the 90% threshold is reached. A concrete requirement specifying how these volumes should be treated is also needed.

Further details of how to apply Article 4(l) should be provided. Currently, the factor of 50% has to be applied once the absolute value of 80% of the ERM II currency gains is larger than the absolute value of the EUR loss. Further specification is required of whether the less favourable recognition would actually have to be used immediately or whether it would be possible to apply a pro rata reduction of the positive effects down to the 50% factor. Under the current wording, very small changes in the portfolio could result in highly disproportionate changes in the regulatory ratios (cliff effect).

Finally, it is unclear how to apply positive effects in EUR. It should be clarified that the home currency always allows a 100% recognition of gains.

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### Draft Guidelines on the management of IRRBB and CSRBB

#### General

We welcome the consolidation in a single set of guidelines of requirements for internal measurement systems (IMs) for IRRBB and CSRBB. This will make it easier to ensure that requirements are consistent across both risk categories.

We understand, moreover, why the EBA wishes to spell out the requirements for the internal management of interest rate risk in the banking book and supplement them with requirements governing credit spread risk. We welcome the retention of the proportionality principle in the guidelines. We interpret section 4.1.2 and para 41(c) of the consultation paper as meaning that not all requirements have to be met in full by small and less complex institutions. It should be made clear in the text of the guidelines that competent authorities must respect the corresponding relief (no supervisory discretion). There are times, however, when we feel that the proportionality principle is not taken adequately into account (see below).

As a general principle, regulatory requirements should not result in an inability to take account of a bank's individual situation and the ensuing need to adjust risk measurement methods. In particular, as we explain in more detail below, the requirements should not lead to a situation where the usefulness of bank-specific economic analyses and observations becomes so eroded that banks neglect them. A corresponding loss of expertise in the banks will have long-term adverse effects that must also be considered by supervisors. We believe there are times when the draft guidelines fail to meet these criteria for a regulatory framework.

In view of the freedom of methods permitted under Pillar 2, it is essential in this context that the requirements of the directive are "method-neutral". Unfortunately, this is not the case when it comes to the requirements for including idiosyncratic risk in the measurement of CSRBB (see also our answer to question 3). As we see it, method neutrality also means that it should be possible to satisfy the NII and EVE requirements for modelling CSRBB with the help of both scenario-based and VaR-based IMs.

- Expanded definition of net interest income (NII):
  - To begin with, the additional consideration of the valuation result will lead to increased complexity and less comparability.
    - Write-downs and write-ups depend on national GAAP or IFRS and on the options exercised by institutions.
    - For banks that do not use IFRS, some of the explanations will be difficult to interpret (e. g. "market value changes of instruments shown in the profit and loss account or directly in equity").
    - The NII definition is inconsistent with that for the purposes of FINREP, where the amount of realised NII continues to be the difference between interest income and



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interest expense. This discrepancy and potential for confusion is problematic, in our view, especially when disclosing risk measures to the general public.

- It can result in arbitrarily high limit utilisation even if the NII risk is low in absolute terms (small denominator problem).
  - It connects unrelated items (the reason for administrative costs may be totally unrelated to NII exposure) and creates volatility and dependency in NII limit utilisation on non-interest rate items.
- In addition, use of the broader definition will entail disproportionate time and effort. It requires the interest-induced valuation result to be isolated from other valuation corrections. A range of assumptions (e. g. about exchange rates, interest rate volatility, etc.) are needed to do so. This unnecessarily increases complexity and creates additional work without generating any meaningful added value.
- For instance, differentiating between interest-related and non-interest-related net commission income generates a disproportionate operational burden. The inclusion of interest-dependent commission – especially if there is a strong focus on financing through retail deposits – requires complex analysis of the interest rate sensitivity and transmission to customers in different interest rate shock scenarios. At the same time, the interest-related portion of net commission income is generally quite small compared to an institution’s total interest rate risk, so there is no justification for the massive time and effort required.
  - Under German law, moreover, institutions without a trading book, for example, would have to value the liquidity reserve at fair value, while many other items are valued at amortised cost when performing the same check of whether provisions need to be set up in accordance with BFA 3<sup>2</sup> due to a lack of fair values at banking book level. The valuation of pension provisions under German GAAP depends on the interest rate level without fair value changes having any real direct influence on the calculation of profit and loss under German GAAP. As things stand, the regulatory framework for IRRBB takes no account of German GAAP-specific effects. This may result in the broader NII definition requiring banks to model effects that do not represent a relevant risk.
- Last but not least, the inclusion of valuation effects in the NII is not appropriate from an economic point of view. Changes in present value can only be captured appropriately using the EVE method. They are fundamentally different from the P&L valuation effects following price movements of the valued products since, unlike under the EVE approach, valuation or accounting options in the P&L context may distort the actual price movements.
- This would, for instance, be the case if securities are held for the purpose of hedging interest rate risk that arises from liabilities recognised at amortised cost. Using the EVE method, the change in value of both “sides” is recorded, while a distorted picture

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would arise under the NII method due to the inclusion only of the change in the value of the securities.

- The information content of valuation effects is therefore often lower than that of changes in present value. Consequently, an assessment of the change in the present value should continue to be based on the EVE approach while, at the same time, the NII method should be restricted to NII. On no account should the EVE and NII methods be combined.
- Forward-looking EVE:  
We would like to point out that the use of a run-off balance sheet in an EVE simulation, which is described in para 102 as having "limitations", is a key element of the present value risk perspective. By contrast, though the periodic assessment includes rollovers, it does not – like the present value perspective – include future cash flows in their entirety. For this reason, both perspectives are considered in risk management. Additional analysis of the EVE metric with consideration of rollover assumptions would be neither relevant nor meaningful and would require a disproportionate amount of time and effort. We therefore recommend deleting para 102.

The requirements in para 103 are unclear, as is the economic rationale. Institutions for which the effects of repricing restrictions are material take these into account in the context of model validation. Para 103 should therefore also be deleted.

### *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 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.*

Provided that the cap is defined as a weighted average – as envisaged in para 111 – we see only limited potential for unintended side effects. We see no danger of results being significantly distorted. The reference to the weighted average should therefore definitely be retained. On several occasions in the paper (such as in this question) the wording is inconsistent and mentions a cap on the maturity itself rather than the average. The wording should therefore be adjusted accordingly.

The exclusion from the modelling of wholesale NMDs from financial customers is not appropriate and in no way reflects the reality to be modelled. Moreover, this approach is not consistent with the Basel standards.

### *Question 2:*

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

We support the idea of considering an internal measurement system (IMS) non-satisfactory if a case-by-case analysis concludes that the system does not materially comply with the guidelines. We see no need for further detailed assessment criteria and believe para 119 should therefore be deleted.

Should para 119 nevertheless be retained, we would ask for the following points to be taken into account:

It is totally understandable that basis, gap and option risk should have to be measured. But it should be made clear that separate measurement of these three risk sub-categories is not necessary and that a lack of separate measurement will not lead to categorisation as "non-satisfactory".

In para 119(b) it is not clear what is meant by "calibrated" and "reviewed". Who is supposed to be reviewing what: risk controlling, internal audit, ...? It would also make more sense to replace "back testing" with the broader term "validation".

We welcome the fact that the proportionality principle has been taken into account in the process of identifying inappropriate methods and procedures. However, some of the explicit requirements would require small institutions and institutions with non-complex portfolios to expend a disproportionate amount of time and effort, so we assume that the principle of proportionality will apply here too. Examples are the consideration of basis and option risk, the extensive, detailed requirements for reviewing and validating internal models, and the requirement in para 112(h) to isolate the impact of behavioural assumptions by using contractual terms instead. The realisation of contractual maturities is a strong behavioural assumption in itself and not suitable as a point of reference. This requirement should be dropped for all institutions. The requirement in para 109(b) concerning the analysis of elasticity in behavioural options is also unsuitable for small institutions since price effects from elasticities can only be mapped with the help of complex derivatives (a EUR 100 deposit, 70% of whose interest rate is linked to a current interest rate, is no longer worth EUR 100 in the event of an interest rate adjustment. This problem can be circumvented by using moving averages, for example).

We see a need to specify the procedure for handling institutions when a competent authority is considering classifying their modelling as non-satisfactory. First of all, the institution in question should be given a reasonable period of time in which to remedy identified shortcomings and thus avoid this classification. If an institution needs to switch to the (simplified) standardised methodology, orderly arrangements should be in place for doing so and there should be an adequate transitional period so that the institution can implement the methodology properly and make the necessary technical adjustments to its systems.

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Conversely, there should be a clear and straightforward road map for reverting to a (satisfactory) internal system in order to avoid undermining the incentive to use internal systems. This applies to both the standardised and simplified standardised methodologies (i. e. it should not be necessary to go via the standardised methodology). We assume that once identified shortcomings have been remedied, it will be possible for an institution to revert to its internal system without undue delay.

Moreover, given that many banks in Germany do not prepare their accounts in accordance with IFRS, the requirements should be formulated in such a way that they make sense for all institutions. The text should be adjusted accordingly.

We agree 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 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 analysed 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 conflicting steering implications. A lack of internal limits in one perspective should not lead to a bank's internal methods being classified as non-satisfactory.

In addition, we recommend streamlining the text of some requirements to avoid duplication (e. g. paras 154 vs 155 and 146 vs 149).

### *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?*

The draft guidelines propose to change the definition of CSRBB set out in the old 2018 guidelines. While para 7 of the old guidelines refers to the "risk driven by changes in the market perception about the price of credit risk, liquidity premium and potentially other components of credit-risky instruments ... which is not explained by IRRBB or by expected credit/(jump-to-)default risk", the new para 7 defines CSRBB as the "risk driven by changes of the market price for credit risk, for liquidity and for potentially other characteristics of credit-risky instruments, which is not captured by IRRBB or by expected credit/(jump-to-) default risk."

The impact of this change is unclear; equally unclear is whether a material change is intended at all. In our view, the risk of a change in market price implies the existence of (fluctuating) market prices for products in the relevant business segment. Market prices are generally not available in the area of conventional customer lending. This area consequently falls outside the scope of the definition. German banks, for example, finance a large number of small and medium-sized businesses (such as "the baker on the corner") for whose financing no market

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prices are available and thus no credit spreads can be determined. This also applies to residential real estate finance. If meaningful market information is available (e. g. for the corporate bond portfolio), these positions should be included in the measurement of CRSBB. Specifically, this therefore applies to transactions for which credit spreads are relevant, especially securities transactions. It should also be possible to exclude certain positions from the risk assessment to avoid double counting. This will be the case, for instance, if it can be demonstrated that the corresponding risks are already assessed and managed elsewhere (e. g. in combined credit risk and credit spread risk models).

There is currently no industry standard for measuring CSRBB: on the contrary, approaches differ widely. No industry standard should be "enforced" in this area by the EBA. Requirements should be "modelling neutral", which is not the case at present. A typical example of the use of trading book VaR models adapted for banking book purposes is the integrated measurement of IRRBB and CSRBB including idiosyncratic risk (with or without changes in individual creditworthiness). Alternatively, credit risk models can be extended to include components for CSRBB measurement which enable an integrated risk measurement on the basis of creditworthiness and market-induced spread changes. When such integrated models are used, there is a particular danger of the proposed procedure quickly leading to double counting, which must be avoided at all costs. Existing models are all well understood and have proved their worth; it should continue to be possible to use them.

According to para 157, however, it will only be possible to include idiosyncratic credit spread components in CSRBB measurement if it can be demonstrated that the results will be conservative. This alleged relief is nothing of the sort and the obligation to produce evidence should be deleted since, depending on the observed reporting date, inclusion may lead to either an increase or a reduction in risk as a result of possible diversification effects that the inclusion may generate. Since the consideration of additional elements of the overall credit spread risk tends to increase unavoidable double counting owing to overlaps with migration and default risk, results should be considered conservative per se and permitted without any requirement for verification. By contrast, a precise measurement of the individual components of credit spread risk (market spread, liquidity spread, separate consideration of idiosyncratic spread) may be desirable in theory but cannot be accurately carried out in practice. The explanatory box on page 46 includes a qualification to this effect. Even if separate consideration of the spread components were possible, the question arises as to whether this would offer any added value and make a meaningful contribution to a bank's risk management practices. For example, the default premium might already be included in the credit risk and the liquidity premium in the liquidity risk of the institution. Anticipated rating changes, i. e. expected migration to other rating classes, may in turn have an impact on the default premium and possibly the liquidity premium.

We believe greater account should be taken of an institution's individual circumstances (portfolio composition, design of internal systems, availability of reference data, etc.) when assessing credit spread risk. It should be up to the bank itself to decide on the specific design

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of its system, including whether to opt for integrated or isolated measurement. Analysing currency-specific dimensions, for example, as proposed in para 123, will not make good sense for every bank. For all larger portfolios, further clustering (such as by rating class, sector, region, product, or possibly also more granular, issuer-specific mapping) is required for internal risk management purposes and has thus become market standard. It should consequently be up to institutions to choose which type of clustering is most appropriate. This is the only way, in our view, to achieve meaningful results from which sensible risk management practices can be derived. On top of that, a generic and arbitrarily constructed curve will lead to inappropriate mapping of the credit spread risk of certain portfolios and thus to undesirable risk management incentives. Institutions should therefore be allowed to use bank individual appropriate credit spread curves with which observable market prices are also set for traded instruments.

Backtesting (realisation vs forecast) does not always provide meaningful results and is sometimes not possible at all. It is not possible, for example, to observe on the market the "actual result" of a loan to a client such as the baker on the corner (see, in particular, para 147). The question therefore arises as to what value should be backtested in such cases and what meaningful implications (in terms of risk management takeaways) should be derived from this theoretical exercise.

### *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 recommend a narrower interpretation of the CSRBB perimeter, which we believe would also be consistent with the Basel standards. Given their sensitivity to credit spread risk, fair value positions would generally be included. Positions where changes in the balance sheet value are not observable, such as those accounted for at amortised cost, would generally be excluded from the CSRBB perimeter as they have no (material) influence on credit spread risk and their inclusion would give rise to extremely costly calculations.

According to our understanding of the definition of CSRBB (cf. our reply to question 3), positions should, in addition, only be included in the scope of CSRBB measurement if meaningful market information is available about them. Reference prices are not sufficient in this respect: position-specific prices must be available. This means instruments must be eligible for trading on a stock exchange and have a certain minimum market liquidity. Prices from secondary markets, by contrast, are not a suitable means of measuring CSRBB (registered bonds traded on secondary markets with only issuer spreads would also have to be excluded, for instance). In summary, therefore, only liquid securities positions measured at fair value in the banking book should be included in the measurement. As we see it, this is the only way to achieve appropriate risk management incentives.

In particular, we strongly oppose the requirement in para 124 for institutions not to exclude certain positions ex ante but to provide detailed documented evidence of an "absence of

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sensitivity to credit spread risk” for each exclusion of a group of similar positions. This will not be feasible to implement in practice since, for items such as customer loans or demand deposits, evidence of this kind is virtually impossible to document in a way which is audit compliant. It would make more sense to assume that CSRBB generally plays no material role for certain types of products (with negative lists at least at national level). If neither idiosyncratic risk nor migration and default risk are taken into account, this assumption is likely to be largely correct. Even if credit spread changes were observable for these product types, they would play no role when it comes to conditions for either new or existing business (in a classic buy-and-hold business model). The changes would have no influence on P&L nor, in consequence, on equity and would ultimately have no effect on the bank’s solvency. Their measurement would therefore be irrelevant.

We also recommend that pension plans (assets and liabilities) be explicitly excluded from the scope. The pension plans of banks should be excluded from the scope of CSRBB because of the way they are uniquely governed and managed relative to the bank’s commercial activities. Pension plans, specifically defined benefit plans, contain credit-risky investments along with equities and other investments in order to hedge the credit-risky liabilities of the plan. These investments are managed by an investment manager, typically a third-party asset manager, and governed in many cases by a board of trustees who are either independent or semi-independent of the bank. In other words, the bank may not be able to legally apply these guidelines to those plans, especially considering the granularity of requirements envisioned by the revised CSRBB rules. Even where the bank is able to influence investment strategy, it takes a portfolio approach that looks at the overall risks of the plan across assets and liabilities and establishes broad investment guidelines for the investment manager to adhere to. We do not think the rules were intended for pension plans and ask that they be explicitly excluded from the scope of CSRBB.

Furthermore, pragmatic procedures should be established to enable individual institutions to exclude other non-material positions from the scope if necessary.

In special cases and depending on the bank’s business model, the competent authority could subject further transactions to a review of the relevance of CSRBB.

### *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?*

## **Additional detailed remarks**

- 4.1 General provisions, para 15: The assessment horizon should be set out and defined clearly and consistently. Para 15 refers to a short and medium-term horizon, but the

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following explanatory box on page 19 talks of an assessment “in the shorter and longer term”.

- 4.3 Measurement of IRRBB by an institution’s internal system, para 82: “If commercial margins and other spread components are excluded from economic value measures, institutions should (i) use a transparent methodology for identifying the risk-free rate at inception of each instrument; and (ii) use a methodology that is applied consistently across all interest rate sensitive instruments and all business units.”

We propose amending the wording as follows: “If commercial margins and other spread components are excluded from economic value measures, institutions should (i) use a transparent methodology for identifying the risk-free rate at inception of each instrument; and (ii) demonstrate that any methodologies used produce a consistent output across all interest rate sensitive instruments and all business units.” Complex products tend to require more complex models; such a level of modelling complexity may not, however, be required for simpler products. Given the higher volume of simpler products and provided that the institution can demonstrate that the simpler model produces consistent results for that product set, it would make sense not to require the roll-out of the more complex model. Provided that the institution demonstrates the consistency of the models in the simpler case, this would allow a simpler model to be used in this higher volume case. Similarly, banks are not required to use full Monte Carlo simulation methodologies across all products where they can demonstrate that a simpler analytical model is equivalent. While this is not a material change to the former guidelines, we would nevertheless like to highlight the above issue. Apart from the rationale outlined, we also believe the guidelines go beyond what was described and required in para 70 of the underlying Basel Committee on Banking Supervision (BCBS) standard on IRRBB published in April 2016, which requires banks to disclose whether banks include or exclude commercial margins. The requirement for a unified approach was only introduced by the EBA guidelines and is in practice incompatible with the intention of the BCBS provision.

- 4.5 Identification and assessment of CSRBB, para 126: We consider a separate CSRBB strategy unnecessary and would recommend that the idea be dropped. CSRBB is normally assessed as part of an overarching IRRBB and CSRBB strategy. We believe this to be sufficient.



## Comments

### Draft RTS on standardised methodologies on IRRBB

#### General

We warmly welcome the clear statement on page 12 of the draft RTS that it is not the intention to replace internal methods (IMs) with standardised methodologies. Standardised methodologies should merely be used as a temporary fallback solution in the rare case that an IM is deemed unsatisfactory. It should then be the joint aim of institutions and supervisors to revert to internal approaches as soon as possible. In our view, only an internal measurement system, along with the necessary expertise and risk measurement methods, can ensure an appropriate bank-specific reflection of interest rate risk in the banking book.

With this in mind, we would like to point out that the standardised methodologies will not produce a risk measure appropriate to the individual situation of the bank. The requirements of a standardised method for modelling uncertain cash flows or the valuation of options, for instance, cannot accommodate the different business models of different institutions.

Nor is a standardised approach able to take account of the various specificities of different institutions' clients. We would also point out that, the greater the number of banks required to apply standardised methodologies, the greater the systemic model risk. If the modelling of a standardised approach is not accurate from a bank-specific perspective, this will lead to systematic misvaluation of interest rate risks and thus to significant risks for the banking sector. In addition to the divergence from internal models associated with the use of a standardised model when it comes to pricing, especially in retail lending, management practices and risk management, standardised models thus pose significant risks for banks, regulators and market participants. The only institutions to be exempt from the need to use internal systems should therefore be the institutions mentioned in Article 84(3) of Directive 2013/36/EU that cannot demonstrate the adequacy of their systems. Supervisors should only require the application of the standardised approach as a last resort in exceptional circumstances, however.

Furthermore, standardised approaches should not be used to challenge internal measurement systems (by benchmarking them against standardised approaches). On no account should institutions be required to implement standardised and internal systems in parallel. We would ask the EBA to take a concrete position on this point both in the introductory section of the RTS and in section 4 and to define the precise scope of application.

The (non-simplified) standardised approaches do not appear to be any "simpler" than many internal models; in some respects they are even considerably more complex. This raises the question of whether institutions whose internal measurement is judged unsatisfactory will really be in a position to apply these standardised approaches. We believe that, instead of introducing a complex standardised approach, it would make more sense to specify a simple "minimum standard" for models (with less differentiated portfolios and fewer requirements and

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more freedom of implementation). At the very least, consideration should be given to allowing institutions with unsatisfactory internal models that are not covered by the scope to use the simplified approaches with the approval of their competent authority provided that they have a suitably simple portfolio.

In principle, we welcome the introduction of the simplified standardised approaches to EVE and NII in the interests of proportionality. In our view, however, the simplifications do not yet go far enough.

*Question 1: What is the materiality of prepayments for floating rate instruments and what are the underlying factors? Would you prefer the inclusion of a requirement in Article 6 for institutions to estimate prepayments for these instruments?*

We welcome the exclusion of prepayments for floating rate products given their lack of materiality. Besides the already small impact on the overall risk metrics in the different scenarios, prepayments for floating rate products are typically independent of the interest environment and therefore do not have a significant impact on the delta EVE and delta NII risk metrics which are the key result of this standardised approach.

*Question 2: Do respondents find that the required determination of stable/non-stable deposits, and core/non-core deposits as described in Article 7 is reflective of the risks and operationally implementable? In case of any unintended consequence or undesirable effect on certain business models or specific activities, please kindly provide concrete examples.*

We generally consider the modelling of demand and savings deposits in the standardised approach on the basis of the distinction between "core" and "non-core" volumes applied by many banks to be a sensible choice even for smaller institutions. This will enable banks to take account, within a clearly defined framework, of bank and customer-specific characteristics of their deposits even in the standardised approach.

But the additional distinction between "stable" and "non-stable" should be dropped, in our view, as the two are not unequivocally distinguishable and the approach mixes up interest and liquidity. It is confusing, moreover, that the definition of the stable part on page 18 mentions "under the current level of interest rates" while Article 7(2) on page 23 requires the consideration of "upward and downward movements" over the last ten years. Furthermore, the specification of specific parameters for modelling in no way reflects our understanding of an appropriate model.

Banks' individual models reflect the customer interest rate adjustments intended by the bank. The synchronisation of pricing and risk mapping will be significantly restricted by concrete specifications of what constitutes "core" – be they strict upper limits and scenario-dependent factors (under the standardised approach) or direct mandating of precise proportions (under the simplified standardised approach). This will lead to incorrect risk measurement. We would

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like to reiterate our view that, in general, standardised approaches can be no substitute for appropriate internal models in the IRRBB environment.

Moreover, the exclusion from the core category of wholesale NMDs from financial customers is neither appropriate nor consistent with the Basel standard.

*Question 3: Do respondents find that the required determination and application of a conditional prepayment rate and term deposit redemption rate as described in Article 8 and 9 is reflective of the risks and operationally implementable? In case of any unintended consequence or undesirable effect on certain business models or specific activities, please kindly provide concrete examples.*

We find the determination and application of a conditional prepayment rate as described in Article 8 operationally implementable. However, we do not agree with the definition of the exception/threshold in Article 8(2). Rather than defining a threshold based on 2% of total fixed rate loans, we would suggest a threshold based on the impact such options will have on the results. Under the currently envisaged requirements, a bank that allows a full loan repayment for 1.9% of the positions referred to in Article 2(2) would not have to model its prepayment whereas a bank that allows a 5% repayment for 2% of its positions would have to include the impact. We believe it would be more appropriate to determine materiality based on the percentage of possible prepayments.

Throughout the document, it should be made clear that the estimation has to be applied consistently over time (cf. Article 9) and not that the estimator itself has to be consistent (cf. page 9 vs page 26).

*Question 4: Is the treatment of fixed rate loan commitments to retail counterparties clear and are there other instruments with retail counterparties where a behavioural approach to optionality should be taken?*

Yes, the approach is clear. However, we propose including a materiality threshold under which such instruments need not be included.

*Question 5: Do respondents find that the required determination of the impact of a 25% increase in implicit volatility as described in Article 12 is operationally implementable?*

First of all, we would like to point out that not every institution is able to perform full revaluations, which may make it impossible for this approach to be applied by all institutions. Even if a full revaluation is possible, there are significant operational challenges. The current definition of products that fall under this full revaluation requirement is too broad, making it impossible for such banks to implement without disproportionate time and effort.

Examples of products that currently fall under the definition:

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- Floating rate products with an implicit floor of 0% either on the total customer rate or the reference rate
- Wholesale fixed term deposits with an early redemption right under Article 9(3)
- Implicit 0% floors on non-maturing retail deposits

We would also appreciate it if the EBA provided details of the empirical information on which the assumption of the 25% increase is based.

*Question 6: Do respondents find that the required slotting of repricing cash flows in accordance with the second dimension of original maturity/reference term as described in Article 13 is operationally implementable?*

The approach is comprehensive. However, it will be challenging to collect the relevant data and operationally challenging to perform this calculation on a regular basis.

In particular, the cash flow slotting under shock scenarios is far too complex and the economic rationale is not clear since the core component is the part of the NMDs that "is unlikely to reprice even under significant changes in the interest rate environment".

Furthermore, we do not understand the rationale behind the structure of the reference term time buckets and would appreciate more detailed explanation of the economic background on why this is deemed appropriate.

Also, the EBA should clarify how to treat non-contractual cashflows such as early redemptions and prepayments regarding their repricing term. If, for example, 50% of a fixed deposit is modelled to be redeemed O/N, it should be clarified whether it should be reinvested with the O/N shock or at the initial maturity.

*Question 7: Do respondents find it practical how the determination of several components of the NII calculation, with in particular the fair value component of Article 20 and the fair value component of automatic options of Article 15, is generally based on the processes used for the EVE calculation (in particular Article 16 and Article 12)?*

Yes, this process consistency makes sense.

We would nevertheless like to point out that many small and medium-sized banks in Germany prepare German GAAP accounts. Yet the current definition of fair value effects only applies to banks using IFRS, which will make it difficult for banks using German GAAP to implement the requirements. Smaller banks, in particular, generally have few positions with effects on P&L in different interest rate scenarios. This should be taken into account by setting an appropriate threshold to ensure that such a resource-intensive calculation will only be performed if the underlying risk is actually material for the bank. If the narrow definition of NII is selected for

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the regulatory outlier test, this should also be taken into account concerning the standardised models.

*Question 8: Do respondents find that the calculation of the net interest income add-on for basis risk is reflective of the risk and operationally implementable?*

We understand the selected approach and the underlying assumptions. It is true that, in principle, basis risk also theoretically exists in an NII approach. We nevertheless consider the inclusion of this risk to be problematic and believe that one-size-fits-all requirements do not serve a useful purpose. We therefore welcome the bank-specific definition of scenarios, as this is the only way to take account of the actual situation of a bank. As with the other elements, however, we feel it would make good sense to introduce thresholds. The diversity of interest-linked financial instruments usually found at smaller banks and specialised institutions with a limited product range is low. In the retail banking environment, for example, there are many institutions with a negligible proportion of variable-rate products with different reference curves. It is important as a general principle that any existing option and basis risks do not have to be measured separately but can be included in an integrated measurement system. This is also true for the EVE approach.

*Question 9: Do respondents find that the adjustments in the Simplified Standardized Approach as set out in Article 23 and 24 are operationally implementable, and do they find that any other simplification would be appropriate?*

- (Simplified) standardised approach to EVE
  - General approach:

We understand the general approach and welcome the clarification of ambiguities in the existing standardised approach of the Basel Committee, especially with regard to the modelling of demand and savings deposits and the definition of automatic options. It is nevertheless apparent in important areas that the standardised approach and simplified standardised approach are not suitable for small, medium-sized or non-complex institutions and are generally too complex. This is particularly evident when it comes to the requirements for considering option and basis risks, demand and savings deposits and early repayments. For details, see below.
  - Automatic options:

It will not be possible for many small banks to calculate the value of automatic options in accordance with Article 12 using a scenario-based full valuation as they do not have the technical capability or expertise to carry out such a valuation. For small, non-complex institutions, on the other hand, the simplified standardised approach offers a feasible way of taking these options into account. We support such an approach but would point out that the results thus obtained will be correspondingly imprecise. We also believe the standardised approach should contain a materiality threshold for automatic options below which they do not need to be considered.

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- Early repayment:

We welcome the EBA's proposal to enable a clear standardised approach to dealing with early repayment. Here too, however, the time and effort involved in implementation should be in proportion to the materiality of influencing factors. The proposed thresholds for the consideration of early repayment are not appropriate in our view. The consultation paper currently envisages that early repayments should be modelled as soon as 2% of total assets consist of fixed-interest assets with early repayment rights in accordance with Article 8. This would affect a lot of German banks given the scale of their fixed-income lending. Yet this threshold relates only to the volume and not the impact of such repayment rights, which is not appropriate in our view. We would recommend setting thresholds that relate to the expected impact on the risk figure instead of the absolute volume of products with options.

- (Simplified) standardised approach to NII

- We appreciate the attempt to simplify the NII standardised approach for small, non-complex institutions. However, the requirements are still rather complex (data requirements, options, margins, basis risk, fair value changes).

- General approach:

In addition to the following NII-specific challenges, our above comments on Articles 7 to 12 relating to the EVE standardised approach also apply.

- Consideration of margin:

Based on the EBA's assumption in the explanatory box under Article 18 that margins are not materially sensitive to interest rates, the effect of margin payments on delta NII is not relevant except for minimal changes caused by scenario-specific cash flow changes. To determine the effects of margin adjustments, however, banks will have to prepare the term linkage table introduced in Article 17, which will require substantial additional time and effort. Of primary relevance for regulatory purposes is the risk measure of delta NII, provided option A is selected in the SOT for NII, which we believe is the metric that makes most sense. We therefore recommend only prescribing the delta NII calculation in the standardised approach provided that it is sufficiently conservative and ignoring the absolute NII along with margin effects.

- It should be made clear that no breakdown into counterparties is required in the empirical determination of commercial margins.
- Like in the EVE simplified standardised approach, the treatment of NMD does not reflect the actual behaviour of small banks, where deposits are one of their core competences.

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- We also suggest only considering the reinvestment of the principal in line with the constant balance sheet definition as the priority and focusing on delta NII in a narrow sense. This will simplify the currently very complex calculation and make implementation much more feasible. This is particularly important as the approach should also be implementable by banks whose interest rate risk management has been deemed inadequate.

*Question 10: Do respondents find that all the necessary aspects are covered and the steps and assumptions for the evaluation of EVE and NII as laid out in the standardized approach and simplified standardized approach clear enough and operationally implementable?*

We would like to stress that standardised approaches should not be used to challenge internal measurement systems (by benchmarking them against standardised approaches). On no account should institutions be required to implement standardised and internal systems in parallel. In any event, the data collection for a parallel calculation would be far too time-consuming (cf. our reply to question 6). We would ask the EBA to take a concrete position on this point both in the introductory section of the RTS and in section 4 and to define the precise scope of application and spell out its boundaries.

We would like to point out that inconsistencies may arise if internal systems are used for one perspective (EVE/NII) while the (simplified) standardised methodology has to be used for the other. With respect to NMDs, for instance, different cash flows could be modelled in the two perspectives: one cash flow that appropriately maps the institution's planned interest rate adjustment policy and one cash flow constructed according to prudential regulations. In this case, differing risk management incentives could arise, not only from the differences between the EVE and NII methods but also from the diverging cash flows. This would significantly complicate the interpretation of the results. Solutions to this problem should be explored. One option would be the simultaneous application of the (simplified) standardised methodology in both perspectives – even if a satisfactory internal system exists for one of them.

### **Further detailed comments:**

Article 4(g) defines a materiality threshold for the NPE ratio of 2%. NPE ratio in these draft RTS is defined as "For these purposes, non-performing exposures are determined by non-performing debt securities, loans and advances, while the non-performing exposures ratio is calculated as the amount of non-performing exposures divided by the amount of total gross debt securities, loans and advances [..]".

The wording differs from the "EBA Dashboard Q3 2021 v2.pdf", page 42, Risk Indicator code AQT\_3.1, which defines the NPE ratio as "Non-performing debt instruments (loans and advances & debt securities) other than held for trading to total gross debt instruments".

We suggest aligning the wording in the RTS with that used in the EBA Dashboard.

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In addition, Article 20 of the draft guidelines on IRRBB and CSRBB requires institutions to also consider “other off-balance sheet items”. Such items can also attract NPEs and should therefore also be reflected in the NPE ratio definition. Furthermore, cash balances and other demand deposits may also incur NPE.

We think that the NPE ratio definition should be amended as follows: “For these purposes, non-performing exposures are determined by non-performing debt securities, loans and advances, cash balances at central banks and other demand deposits **and off-balance sheet exposures**, while the non-performing exposures ratio is calculated as the amount of non-performing exposures divided by the amount of total gross debt securities, loans and advances, cash balances at central banks and other demand deposits **and off-balance sheet exposures** [..]”

Small and non-complex institutions will not be able to carry out the analysis of pass-through rates required in Article 7(5) because a pass-through rate can only be modelled with the help of complex derivatives.

It is unclear precisely what instruments are meant by “non-interest derivatives ... referencing an interest rate” (Article 2(2)(b)). We would appreciate clarification.

In Article 3(4), “increase of short-term interest rates” is defined for various purposes. The purpose for Article 23 has been omitted, however.

Finally, we would like to point out that a number of cross-references in the consultation papers are incorrect. We therefore recommend checking the references again before finalising the standards and guidelines.