The Managing Director

Mr Martin Merlin
Director Banking, Insurance
& Financial Crime
DG FISMA
European Commission

Brussels, 20 December 2022

Subject: EBA draft RTS on IRRBB SOT and EBA GL on IRRBB & CSRBBB

Dear Mr Merlin,

The European Savings and Retail Banking Group (ESBG) would like to reach out to you with regard to the draft European Banking Authority (EBA) Regulatory Technical Standards (RTS) on interest rate risks for banking book (IRRBB) supervisory outlier tests (SOT) *[EBA/RTS/2022/10]* and the EBA Guidelines on IRRBB and CSRBB *[EBA/GL/2022/14]*, which have been published on 20 October 2022.

More specifically, we have identified two aspects within the EBA RTS and GL whose introduction would not be fully justified and that in our view should be reconsidered. These are:

1) The level of the SOT threshold for a "large decline" in net interest income (NII), which has been set at 2.5% of Tier 1 capital, and
2) The proposed perimeter of items exposed to the CSRBB framework.

1) The SOT threshold for the definition of "large decline" in NII:

Concerning the SOT threshold for the definition of large decline in NII, the draft EBA RTS on IRRBB SOT says in Article 6 that a decline of an institution's one-year NII by more than 2.5% of its Tier 1 Capital, resulting from a sudden and unexpected change in interest rates as set out in any of the two supervisory shock scenarios set out in Article 1, shall constitute a large decline for the purpose of Article 98 (5), point (b) of Directive 2013/36/EU. A breach of this large decline threshold would result in supervisory actions, thus limiting the risk management of banks in practice.

We believe that **the threshold of 2,5% in NII suggested by the EBA is not appropriate** as it was calibrated in a low interest rate environment. The data gathered by the EBA in 2020 and 2021 through its quantitative impact study (QIS) were collected in a very specific (low interest rate) environment, characterised by limited NII shocks, and therefore cannot be used to determine the level of the threshold. Additionally, the decision of the EBA to use a sample of outlier banks instead of a dangerous level of NII risk make it so that the calibration of the threshold is highly dependent on the characteristics of the banks included in the sample and on the time period observed.

European Savings and Retail Banking Group - aisbl
Rue Marie-Thérèse, 11 ▪ B-1000 Bruxelles ▪ Tel: + 32 2 211 11 11 ▪ Fax: + 32 2 211 11 99
E-mail: first name.surname@wsbi-esbg.org ▪ Website: www.wsbi-esbg.org

Empirical evidence from a study published by Barclays on 27 November 2022 analysing a sample of 38 banks shows that the application of the formula suggested by the EBA would result in a large number of banks exceeding the 2,5% threshold for the definition of "large decline" in NII. Barclays' estimation relies on data from Q2-22/Q4-21 Pillar 3 reports and on disclosure from last company data (Q3-22) assuming a managerial NII sensitivity on the same shock, i.e. 200bps. In both cases roughly half of the banks in the sample fail to meet the NII shock threshold, thus highlighting its inconsistency compared to current market conditions.

Another issue is that the EBA QIS for the purpose of calibrating the threshold was done on the basis of a small number of large banks at a consolidated level, while in practice the threshold will also apply at entity level. At a consolidated level, a large decline in net interest income in one subsidiary can be offset with the net interest income in other parts of the group, whereas this is not possible if the threshold is applied at entity level. Consequently, data collected at consolidated level cannot be the basis for the calibration at entity level because such offsetting effect is not available in this case. This is especially relevant for entities with a significant share of their business in currencies that are subject to an increased interest rate shock above 200bp applicable for many non-Euro based European markets. Given different market practices with respect to fixed and variable customer business, the foreseen threshold of 2.5% for NII-SOT forces smaller institutions to manage their NII exposure with significant amounts of derivative instruments which may create additional issues, e. g. related to hedge accounting and might not even be possible in the absence of a developed derivatives market. Furthermore, the calibration of the threshold based on a QIS performed at consolidated level completely overlooks the specificities of thousands of individual banks and the tolerance of different business models to withstand NII shocks

Under these circumstances, the application of the draft RTS as proposed by the EBA would result in a disproportionate number of banks that could appear as outliers, with a potential additional capital requirement impact on those institutions and with non-risk sensitive changes that institutions would have to implement to avoid being wrongly perceived as outliers. We therefore suggest that the **EBA continues monitoring the situation while transitioning from a low interest rate environment towards a normalization of the monetary policy and only afterwards re-calibrates the height of the threshold more line with the current market conditions**.

2) The perimeter of the CSRBB framework:

Regarding the suggested perimeter of items exposed to the credit spread risk in the banking book (CSRBB) in the EBA Guidelines on IRRBB and CSRBB, **the presumption to include all items in the framework is too extensive**. Opening the scope of CSRBB beyond market-valued assets would generate a plethora of casuistries, supported by theoretical concepts and without evidence of cause and effect, and some specific conceptual challenges.

Paragraph 124 of the EBA GL on IRRBB & CSRBB says that institutions should not exclude any instruments in the banking book from the perimeter of CSRBB ex ante, including assets, liabilities, derivatives and other off-balance sheet items such as loan commitments, irrespective of their accounting treatment. This makes the definition of CSRBB very unclear, as it now includes i) amortized cost items, such as mortgages, and ii) items which in general, there is no clear market for (and therefore are not mark-to-market). At the same time, it is also unclear on what grounds institutions can exclude items from the perimeter of CSRBB, as no such criteria is given. It is unclear in particular how items that are not traded (i.e., mortgages or deposits) could have a CSRBB component, hence the introduction of confusions and complexities. This only puts an excessive

operational burden on banks in terms of undertaking these evaluations and it allows for differences in interpretation and thus unharmonized practices across banks and jurisdictions.

To avoid different interpretations and ensure a level playing field, **it should be stated explicitly in the EBA GL that non-marketable instruments, e. g. loans to customers, should be generally exempted from CRSBB**, as they are covered in the credit risk management framework of the bank. The scope of the framework should therefore be restricted to instruments that have a clear market price transparency and that are easily tradable on a large and deep enough market, because only these assets are subject to such a market perception.

Furthermore, adjusting an institution's methodology and business in a six-month period - from the release of final EBA GL until the limit enters into force - does not seem appropriate given current changes going on in the interest rate market. The introduction of a transitional period would therefore be a more appropriate solution as that would allow credit institutions to adjust the structure of their balance sheets if needed.

Thank you very much in advance for taking our proposals into consideration and we remain at your disposal should you have any further questions.

Sincerely yours,

Peter Simon
ESBG Managing Director

Cc:
Mr Almoro' Rubin de Cervin – *Head of Banking Regulation & Supervision, DG FISMA, EC*
Mr Andreas Schirk – *Team Leader, Banking Regulation & Supervision, DG FISMA, EC*