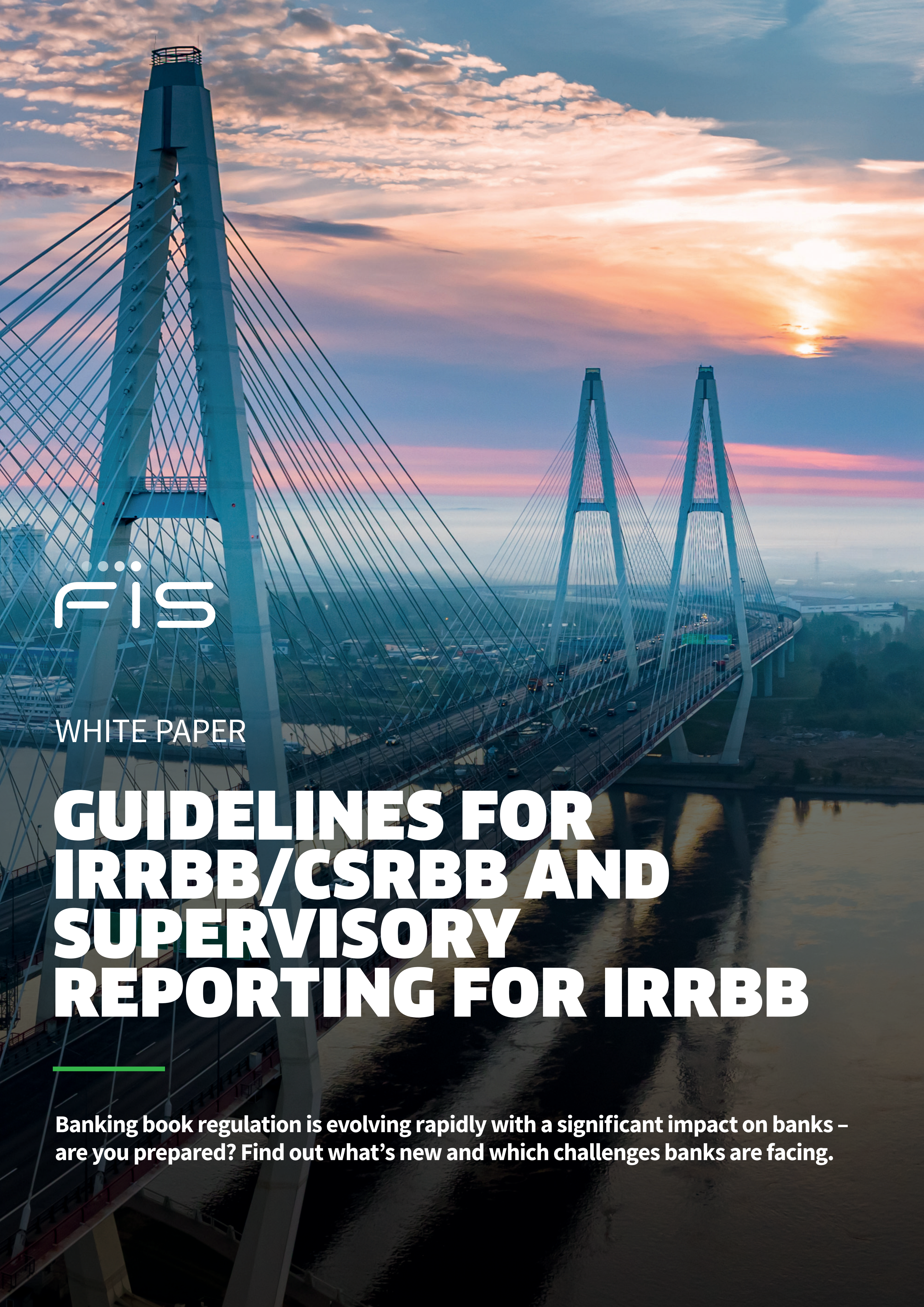


WHITE PAPER

GUIDELINES FOR IRRBB/CSRBB AND SUPERVISORY REPORTING FOR IRRBB

Banking book regulation is evolving rapidly with a significant impact on banks – are you prepared? Find out what's new and which challenges banks are facing.

INTRODUCTION

On July 31, 2023, the European Banking Authority (EBA) published the Final Implementing Standards (ITS), focusing on the reporting of IRRBB which will become part of the COREP 3.4 framework. This is following an extensive package issued in October 2022 covering new final guidelines aimed to overhaul the rulebook for the management of Interest Rate Risk in the Banking Book (IRRBB). In addition to the amendments relating to Interest Rate Risk, the EBA have confirmed and further clarified its increased focus on Credit Spread Risk in the Banking Book (CSRBB) and Fair Valuation impacts.

The relevant regulatory guidelines consist of four papers structured as follows:

- Implementing Technical Standards (ITS) on IRRBB reporting (EBA/ITS/2023/03) which will become part of COREP, strictly applicable to the SOT standard mentioned above.
- Final guidelines for IRRBB and CSRBB (EBA/GL/2022/14) and internal stress testing representing an integral part of ICAAP.
- Standards specifying the supervisory outlier tests (SOTs) for EVE and newly introduced standards for NII SOTs.
- New standardized methodologies both for EVE and NII, which can be requested by competent authorities, if internal systems are deemed to be "insufficient".

The effective dates for the guidelines relating to IRRBB and CSRBB are June 30 and December 31, 2023, respectively. However, the ITS on IRRBB supervisory reporting is compulsory from September 2024. The new regulatory package is binding for E.U. banks, while other regulators like PRA, HKMA and MAS may follow suit in future.

It's on IRRBB reporting

With the aim to create a level playing field and provide supervisors with a harmonized reporting framework to monitor and assess IRRBB exposures, the new IRRBB reporting requirements will become part of COREP 3.4 Framework coming into effect in September 2024. The reporting templates are strictly applicable to the SOT and must be provided quarterly on a group and standalone legal entity level. To take into consideration the scale of institutions and associated cost of reporting, the EBA distinguishes between large institutions, small and non-complex institutions (SNCIs) and other institutions. Depending on the classification of the bank, the fields to be populated can exceed 6000 for large institutions for each currency representing 5% or more of banking book assets or liabilities.

The high-level templates are structured as follows:

- Evaluation of EVE and NII SOT and market value changes under baseline and shock scenarios.
- Breakdown of Sensitivity Estimates split by balance sheet and product categories including optionality impact.
- Repricing cash flows broken down by floating and fixed exposure, product category and contractual vs. behavioral modeling.
- Relevant parameters containing items such as behavioral and prepayment risk.
- Qualitative information.

IRRBB evolution

2016
BCBS standards on IRRBB

2018
EBA guidelines on IRRBB

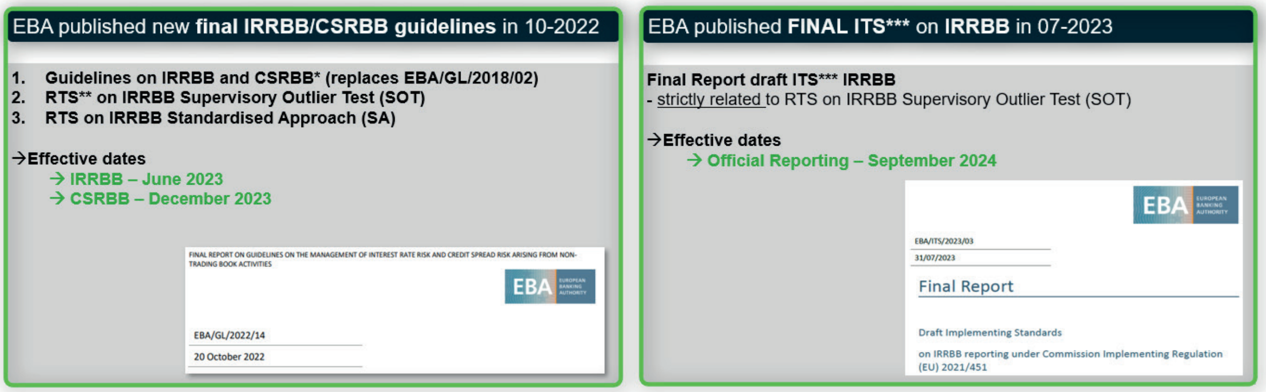
2021
EBA consultation paper on IRRBB & CSRBB

2022
Final EBA guidelines and RTS on IRRBB & CSRBB

2023 (Jun & Dec)
IRRBB: Effective end of June
CSRBB: Effective End of Dec

2023 Q2
Final its on IRRBB reporting

2024 (Q3)
Go live template for IRRBB (COREP)



*CSRBB: Credit Spread Risk in the Banking Book **RTS: Regulatory Technical Standards ***ITS: Implementing Technical Standards

Final guidelines for IRRBB and CSRBB

One specific focus of the new guidelines is the identification and assessment of Credit Spread Risk in the Banking Book (CSRBB), impacting NII and EVE of a financial institution.

The guidelines specify that any instruments sensitive to CSRBB, irrespective of their accounting treatment, are in scope.

Additionally, the EBA emphasizes that as a minimum requirement, institutions should include all positions measured at fair value into the CSRBB assessment and should not exclude any off-balance-sheet positions bearing credit spread risk in the non-trading book.

To avoid misinterpretation, the EBA does not specifically limit CSRBB to corporate/governments bonds and other securities usually measured at fair value through OCI but rather encompasses all on- and off-balance-sheet positions which may give rise to an EVE and NII impact. Any exclusions from the scope of CSRBB must be documented accordingly. Institutions may include idiosyncratic credit spread components (own credit, geography, industry, etc.) to the extent they lead to more conservative results.

Furthermore, in the new NII definition, the EBA introduces financial instruments carried at fair value in addition to the existing interest expense and interest income-only components.

Hence, the new NII definition de-facto moves closer to a more comprehensive earnings view which the regulator expects to embed into the limit setting framework.

Besides, the EBA clarified that the full amount of non-financial deposits will be part of the five-year non-maturing deposits cap scope. This means that in the future the modelling of the non-core deposit part will be allowed, while previously the non-core part was deemed to be overnight.

Supervisory outlier tests (SOTS)

The six BCBS scenarios for the supervisory SOT continue to be valid for the EVE calculation. However, the new standards additionally introduce a prescribed SOT for NII, based on the two supervisory parallel up and down shocks (+/-200 bps). The one-year horizon as well as the constant balance sheet assumption for the NII projection remain in place.

Furthermore, the EBA decided to remain with the "narrow" NII definition for the SOT calculations and dropped the initially suggested inclusion of fair valuation impacts to preserve comparability across banks.

Furthermore, the floor in the new standards is moved from –100 basis points to – 150 basis points for the shortest maturity, linearly raised to 0% at 50 years.

Finally, a "large decline" threshold was introduced for NII of Tier 1 Capital, which was originally set at 2.5%. To take into consideration the sharp movements in interest rates, EBA published an "Opinion on the RTS on SOTs" which increased the NII large decline threshold to 5%.

New standardized models for IRRBB

Competent authorities are entitled to require banks to apply a standardized methodology, provided their internal models are not sufficiently capturing the interest rate risk in the banking book.

Hence, the EBA has developed a standardized (SA) and simplified standardized approach (s-SA) for EVE and NII based on slotting of cash flows.

Fair valuation impacts (through PnL or OCI) are confirmed to be in scope when assessing NII using the standardized models.

The standardized approaches, however, are expected to remain a transitory fallback option or a means of "validation" of results rather than business-as-usual, long-term solutions.

"Reflections will be valid for IRRBB models... How they capture the changes in the current interest rate environment, the way banks will adapt the models and underlying assumptions, the way they will adapt the hedging strategies will be very important for us to understand."

Delphine Reymondon, Head of Liquidity, Leverage and Capital Unit, EBA

Risk.net, October 2022

FIS® Preliminary assessment

Overall, the new guidelines provide valuable clarification and additions to IRRBB and CSRBB. They address some of the regulatory uncertainties which crystalized over the past years in practice.

The new ITS on IRRBB reporting, however, will pose significant challenges to financial institutions. This is driven by the fact that the required granularity of results to populate the 6000+ fields simply does not exist in many banks. The delivery of these templates will require a close collaboration between Treasury, risk, finance and regulatory reporting teams which usually are using different systems with non-unified data models, different consolidation circles (e.g., IFRS vs. regulatory). The new and regular reporting process using XBRL will require standardization, consistency of data and an efficient process to satisfy validation rules and delivery timelines. Furthermore, classic regulatory reporting software banks have become used to, are not built to deliver such sophisticated and granular reports which require sophisticated calculations.

When assessing IRRBB/CSRBB for internal management, the incorporation of fair value effects for credit and interest rate sensitive instruments will require banks to re-assess balance sheet positions which might have been previously out of scope. Potential examples include:

CSRBB for EVE and NII metrics:

- Debt instruments at amortized cost (AC).
- Debt instruments at FVPL/FVOCI.
- Off balance sheet items IRRBB for NII metric.
- Banking book positions held at amortized cost which are economically hedged with swaps (FVPL) and mitigated by hedge accounting.

Depending on the structure, complexity and applicable accounting standard of a given bank, the inclusion of interest-rate-sensitive fair value impacts into the NII definition might result in overlapping effects with the EVE calculation.

Credit risk and NII fair value impacts in the banking books will continue to be a focus area of the ECB and EBA over the coming years which already form part of the EBA stress testing exercises for E.U. banks. Regulatory requirements, stress testing and internal risk management continue to move toward alignment.

To accommodate for the low/negative interest rate environment, banks have adjusted their balance sheets, for example, by deploying excess liquidity and acquiring medium- to long-term debt instruments to optimize NII by generating steady interest income. After a prolonged period of persistently low rates, inflation has become an area of major concern and central banks have taken a hawkish stance by increasing reference rates aggressively and at a historical pace. Hence, we recommend banks to expand the sophistication of their own internal shock scenarios given the current economic outlook and potential shortcomings in the six mandatory supervisory shock scenarios (SOT) as they may prove to be too conservative.

It is now key to assess the balance sheet and define strategic steps to optimize earnings and financial resources (incl. capital buffers).

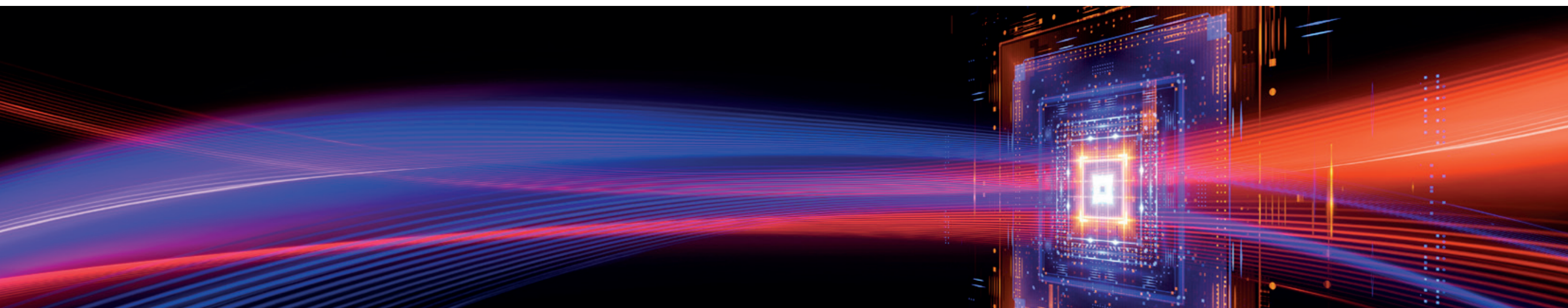
The solution

As a trusted partner of 600+ financial institutions, the FIS Balance Sheet Manager is already actively used by treasury, finance and risk departments around the globe.

The IRRBB/CSRBB assessment under the new definition and scope requires banks to have resilient, flexible and reliable assessment capabilities in place to evaluate the potential stress impact in different scenarios.

Balance Sheet Manager provides a robust platform which fulfils current IRRBB regulation. Additionally, the platform is also capable of addressing the specifics of the new IRRBB/CSRBB requirements, including the new ITS on IRRBB reporting (COREP 3.4) in particular:

- Full revaluation stress testing of interest rate, credit and FX sensitive instruments.
- Full coverage of ITS on IRRBB reporting templates (EVE, NII Market Values) in the required granularity delivered by one integrated platform ensuring consistency of results.
- Comprehensive NII modelling, including out-of-the-box as well as customizable like-for-like balance sheet modelling, flexible behavioural modelling (e.g., prepayments and replication) and re-hedging simulations.
- Flexible scenario definition and capability of handling multiple what-if scenarios.
- Modelling of accounting mismatch and hedge accounting results.



Besides the IRRBB and simulation coverage, Balance Sheet Manager provides an integrated modular platform for treasury, risk and finance for the following subject matters:

- ALM (incl. Stochastic simulations)
- Hedge accounting
- Liquidity risk (incl. NSFR, LCR, ALMM)
- Market risk (incl. EBA Stress Testing)
- IFRS 9 impairment
- Funds Transfer Pricing (FTP)
- Capital management

Our team is experienced in configuring the platform to comply with regulatory standards and meet internal needs. The platform can be easily customized and modified to accommodate for internal management, risk appetite exercises, financial planning and budgeting, reverse stress tests as well as recovery and resolution planning (RRP).

Additional Resources:

FIS Balance Sheet Manager

Guidelines on IRRBB and CSRBB | European Banking Authority (europa.eu)

ITS on IRRBB Reporting (europa.eu)

ARE YOU ON TRACK WITH IMPLEMENTATION?

Regulation is constantly evolving, and IRRBB/CSRBB and the new IRRBB reporting have been named as a core focus area by EBA for years to come. Now is the time to elevate your treasury, risk and balance sheet management to the next level with a modern and strategic platform that can help you improve operational excellence and reduce costs sustainably. **FIS Balance Sheet Manager** can help to get you there!

Let's deliver on IRRBB together

About FIS

FIS is a leading provider of technology solutions for financial institutions and businesses of all sizes and across any industry globally. We enable the movement of commerce by unlocking the financial technology that powers the world's economy. Our employees are dedicated to advancing the way the world pays, banks and invests through our trusted innovation, absolute performance and flexible architecture. We help our clients use technology in innovative ways to solve business-critical challenges and deliver superior experiences for their customers. Headquartered in Jacksonville, Florida, FIS ranks #241 on the 2021 Fortune 500 and is a member of Standard & Poor's 500® Index.

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