

EAPB response to the Basel Committee on Banking Supervision's (BCBS) consultation on targeted adjustments to its standard on interest rate risk in the banking book

The European Association of Public Banks (EAPB) welcomes the BCBS' invitation for comments on its proposed amendments to the IRRBB standard from stakeholders. EAPB's response to the consultation represents the views of over 90 national and regional promotional banks, municipality funding agencies, and public commercial banks across Europe. EAPB members provide financial services and funding for projects that support sustainable economic and social development with, amongst others, activities ranging from the funding of companies and the promotion of a greener economy to the financing of social housing, health care, education and public infrastructure at national, regional and local level.

Recalibration of the standardised shocks

EAPB recognises the appropriateness of recalibration of the standardised shocks using more recent market data. It thinks absolute shock scenarios as proposed better represent the movement in interest rates than relative shock scenarios. Relative shocks are representative of exponential growth models for which there is no evidence such apply to interest rates. Furthermore, for European interest rates, table 8 suggests that the proposed changes, if anything, are less rather than more accommodative.

It is the opinion of EAPB that there is no ground to consider the proposed change from a relative shock model to an absolute shock model as 'accommodative.' Consequently, EAPB does not see a valid ground to use a 99.9th percentile instead of a 99th percentile value for the standardised shocks.

Lacking evidence of increased volatility

The consultation document does not provide clear evidence that interest rates have become more volatile during the period between 2015 and 2022. In addition, the methodology and the selection of history disadvantage EUR banks, i.e. the parallel shock for EUR banks is increased to 250 bp and remains at 200 bp for USD banks. The result of the BIS calculations depends, among other things, on the selected history (start/end time) which is arbitrary. The (unsolvable) arbitrariness in the selection of history inevitably leads to distortions. A uniform shock should be applied for the major currencies such as USD and EUR. Otherwise, the EUR banks would be disadvantaged, especially in relation to the Supervisory Outlier Tests.

Relation to the Supervisory Outlier Tests

In its standards on interest rate risk in the banking book of April 2016, BCBS published revised IRR principles. Principle 12 requires supervisors to implement a supervisory outlier test (SOT) that compares the bank's maximum change in economic value of equity under six prescribed

interest rate shock scenarios with 15% of its Tier 1 capital. BCBS remains silent on the implications of the proposal to apply shocks at the 99.9th percentile instead of 99th percentile. The higher percentile is equivalent to a decrease of the outlier threshold from 15% to 12%^[1]. This could even be closer to 11¼ % for banks bound by the long rates shock up. This hidden and method driven effect might not be clear for non-quantitative stakeholders which would disagree with this untransparent change of the regulatory risk appetite otherwise. A similar argument applies to the outlier criterium on NII set by the European Banking Authority (EBA). Considering how the current outlier criterium for NII was fixed, and causing a delay in its implementation, this would be incomprehensible.

In Europe, SOTs on economic value of equity (EVE) and net interest income (NII) are binding. In addition, European banks will have set even stricter internal limits to these measures. It is precisely in Europe where the proposed wider confidence interval causes an increase in the amplitude of the shocks without an accompanying change in the outlier criterium. This, effectively, makes the supervisory outlier criterium and internal limits more binding. This penalises European banks and contributes to an uneven playing field when other supervisors have not implemented these SOTs.

EAPB urges BCBS to keep the present 99% confidence interval for deriving the amplitudes of the standardised shocks.

In addition, EAPB calls on BCBS to provide more insight into the consequences of rounding the weighted average shocks to the nearest multiple of 50 base points. This methodology could result in severe changes in the amplitudes in shocks when only minimal changes in weighted average changes in interest rates are observed. E.g., the proposed change in the amplitude of the parallel shock for euro rates from 200 to 250 base points, already, could result from an observed 2 base points increase in average rate changes from 224 to 226 base points.

^[1] a linear relationship assumed