Basel Committee on Banking Supervision, Bank for International Settlements, CH-4002 Basel Switzerland

18 March 2024

Re: Consultation on proposed changes to the 2016 Interest Rate Risk in the Banking Book Standard

The School of Business at the University of Dundee is pleased to offer insights on the Basel Committee's efforts to adjust its 2016 Interest Rate Risk in the Banking Book (IRRBB) standard. We sincerely endorse the Committee's efforts to make adjustments focused on updating the calibration of interest rate shock parameters and refining the methodology for calculating these shocks, particularly in low-interest-rate environments.

As a globally recognized institution dedicated to making a significant impact through research, the University of Dundee is committed to meeting the diverse needs of our stakeholders and contributing to informed policy-making through rigorous, impactful research. On behalf of the University of Dundee School of Business, this consultation response is authored by Dr Murat Mazibas, an Associate Professor of Banking and Finance and a former member of the banking industry.

Views on Proposed Changes to the 2016 Interest Rate Risk in the Banking Book (IRRBB) standard

In December 2023, the Basel Committee on Banking Supervision published a consultative document proposing adjustments to its 2016 Interest Rate Risk in the Banking Book (IRRBB) standard. These adjustments focus on updating the calibration of interest rate shock parameters and refining the methodology for calculating these shocks, particularly in low-interest-rate environments.

The Committee aims to address issues with the current methodology's ability to capture interest rate changes during periods when rates are close to zero. The proposal includes:

Expansion of the Historical Data Period: Extending the data period for calibration from January 2000 to December 2022 (previously to December 2015) to incorporate more recent interest rate volatility.

Modification of Global Shock Parameters Calculation: Revising the methodology to calculate local shock factors directly for each currency, moving away from the global shock factors derived from rolling six-month percentage changes in interest rates.

Introduction of the 99.9th Percentile Value: Adopting a 99.9th percentile value for determining shock factors, aiming to maintain sufficient conservatism in the recalibration.

Adjustment of Floors and Caps: Maintaining floors and variable caps to ensure a level playing field and a minimum level of prudence across jurisdictions.

We believe the proposed changes can have the following potential benefits:

Enhanced Robustness and Relevance: By including more recent data and adjusting the calculation methodology, the recalibrated shocks better reflect current market conditions and potential future volatilities.

Improved Precision and Conservatism: The shift to a 99.9th percentile value for shock calculation introduces a higher level of conservatism, crucial for maintaining bank stability in extreme market conditions.

Increased Flexibility for Local Adjustments: Allowing national supervisors discretion in setting higher floors or caps enables a tailored approach that considers local market specifics and idiosyncrasies.

However, the proposed changes can have some potential implications and unintended consequences:

Operational Complexity: Banks may face some increased complexity in implementing the new methodology, necessitating enhancements to their risk management systems.

Potential for Over-conservatism: While aiming for prudence, the heightened conservatism might overly constrain bank activities, particularly in jurisdictions with historically lower interest rate volatility.

Challenges in Data Interpretation and Application: The transition to local shock factors and the broader data range could lead to interpretational and application inconsistencies across institutions.

We are of the view that the proposed changes are both relevant and efficacious in addressing the identified shortcomings of the current IRRBB standard. We believe they can provide a more accurate and contemporary basis for assessing interest rate risk, ensuring that banks are better equipped to manage potential impacts on their economic value and earnings.

We would like to bring the following recommendations to the attention of the Committee:

Guidance and Support for Implementation: The Committee should offer detailed guidance and support tools to assist banks in adopting the new methodology, including examples and best practices.

Periodic Review and Adjustment: Continuous monitoring and periodic review of the shock calibration and methodology should be established to ensure ongoing relevance and effectiveness.

Stakeholder Engagement: Ongoing dialogue with banks, national supervisors, and other stakeholders is crucial for refining the proposed changes and addressing practical implementation concerns.

Impact Assessment: An impact assessment should be conducted to evaluate the effects of the proposed changes on banks' capital requirements and risk management practices.

Our overall view is that the Basel Committee's proposed adjustments to the IRRBB standard represent a significant and necessary evolution in the banking book's regulatory approach to managing interest rate risk. While the changes introduce some specific challenges, their potential to enhance financial stability and risk management practices within the banking sector is substantial.

Many thanks for the opportunity to contribute to this vital and timely initiative.

Best regards,

On behalf of the University of Dundee School of Business

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