IRRBB: Pillar 2 standardised framework – Executive Summary

In April 2016, the Basel Committee on Banking Supervision published a standard on interest rate risk in the banking book (IRRBB) (Standard) as an update to the Committee's 2004 *Principles for the Management and Supervision of Interest Rate Risk*. The Standard includes a clearly enumerated standardised framework for measuring IRRBB. This Executive Summary provides an overview of that framework. You can find further details in the tutorial by the same name.

What does the standardised framework measure?

The standardised framework derives an economic value of equity (EVE) risk measure for IRRBB. It estimates the amount by which the net present value (NPV) of the cash flows arising from a bank's on- and off-balance sheet positions under the **prevailing** term structure of interest rates changes under different **future** interest rate scenarios. The bank's exposure to IRRBB is equal to the largest negative change in EVE (ΔEVE) across all scenarios – in essence, the theoretical risk to the economic value of a bank's equity from a change in interest rates.

Just how "standardised" is the framework?

Many elements of the framework are standardised, including the maturity schedule and six interest rate shock scenarios banks are expected to use. But the framework recognises that not all banking book positions are amenable (or readily lend themselves) to standardisation. Banks may be allowed to use internal parameter estimates to determine the cash flow profile of certain positions, namely non-maturity deposits, fixed rate loans subject to prepayment risk and term deposits subject to early redemption risk, contingent on defined constraints and supervisory review and approval. Alternatively, supervisors can prescribe the baseline estimates banks are to use for loan prepayments and early withdrawal of term deposits under the prevailing term structure of interest rates.

Is the framework mandatory?

The framework is incorporated in a Pillar 2 standard. Consequently, neither supervisors nor banks subject to the Basel capital framework are obliged to use it to determine the minimum regulatory capital requirements for IRRBB.

Supervisors can, however, mandate banks in their respective jurisdictions to follow the framework. Even where this is not the case, banks can choose to adopt the framework as their internal measurement system.

Certain elements of the framework are also reflected elsewhere in the Standard. For example, to identify banks with potentially undue IRRBB, supervisors should use at least one outlier test that compares a bank's ΔEVE with 15% of its Tier 1 capital where the EVE calculation incorporates the interest rate shock scenarios prescribed in the framework. Similarly, regardless of the approach a bank uses for its internal measurement system, for public disclosure purposes the Standard requires that banks measure and disclose their ΔEVE based on these scenarios.

Which banks are expected to implement the Standard, and by when?

Consistent with the scope of application of the Basel capital framework, the Standard applies to all large internationally active banks on a consolidated basis. Under national discretion, supervisors can apply the Standard to other banks and to any subset of entities of internationally active banks. Banks are expected to implement the Standard by 2018.

This Executive Summary and related tutorials are also available in FSI Connect, the online learning tool of the Bank for International Settlements.