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Guidelines on sound management practices and reporting concerning interest rate risk arising from non-trading activities

Scope

This circular letter is applicable to Belgian credit institutions, Belgian settlement institutions and institutions equivalent to settlement institutions, and financial holding companies. They are hereinafter referred to as "the institutions".
The principles and criteria regarding the supervisory review and evaluation process mentioned below essentially apply on a consolidated as well as on a non-consolidated basis.

Summary/Purpose

With effect from 1 January 2016, this circular shall replace Chapter 1 of circular letter PPB-2006-17-CPB on sound management practices concerning interest rate risk arising from non-trading activities and shall transpose the European Banking Authority's guidelines of 22 May 2015 concerning the management of interest rate risk arising from non-trading activities into the Belgian prudential framework.

Structure

1. *Qualitative assessment of interest rate risk in the banking book*
2. *Quantitative assessment of interest rate risk in the banking book*
3. *Prudential action*
4. *Reporting obligations*

Dear Madam
Dear Sir

In compliance with Articles 142 and 143 and Articles 7 and 8 of Annex I of the Law of 25 April 2014 on the status and supervision of credit institutions (hereinafter the Banking Law), with this circular letter the NBB clarifies the principles and criteria on which it bases its supervisory review and evaluation process concerning the management and hedging of interest rate risk arising from non-trading activities (hereinafter 'interest rate risk in the banking book – IRRBB') of an institution. This circular letter hereby replaces Chapter 1 of circular letter PPB 2006-17-CPB.

This circular letter is not applicable to Belgian branches of credit institutions which are not governed by the law of another EEA Member State. With effect from 1 January 2016, also Chapter 1 of circular letter PPB 2006-17-CPB on sound management practices concerning interest rate risk arising from non-trading activities will no longer be applicable to these institiutions. Accordingly, these instutions will no longer be subject to the reporting obligations (reporting table 90.30) included in Chapter 1 of circular letter PPB 2006-17-CPB.

The supervisory review and evaluation process of the supervisor considers both qualitative (adequacy of the institution's risk management; see Part 1 of this circular) and quantitative (level of the risk actually incurred; see Part 2 of this circular) concerns about IRRBB. The supervisor's evaluation of IRRBB based on the principles and reporting described in this circular letter, shall as such serve as the basis for the NBB's Supervisory Review and Evaluation Process (SREP) for those institutions designated as less significant within the Single Supervisory Mechanism (SSM), and shall also contribute to the ECB's supervisory review and evaluation process for the significant institutions directly supervised by the ECB since 4 November 2014.

The supervisor hereby integrally adopts the EBA guidelines of 22 May 2015 regarding the management of interest rate risk arising from non-trading activities, as entered in Annex 1, and moreover specifies additional requirements as to the quantitative assessment and reporting obligations.

Pursuant to Article 143, § 1, 12° of the Banking Law, the supervisor is in this respect expected to take measures if, on the assumption of a sudden and unexpected interest rate movement, an institution is faced with a reduction in economic value exceeding 20% of its regulatory own funds.

However, the supervisor's SREP does not only consider economic value sensitivity, but also earnings sensitivity. Moreover, it is stressed that IRRBB is still regarded as a Pillar 2 risk, which is expected to be adequately managed, evaluated and capitalised internally, whereas prudential reporting aims to compare IRRBB across different institutions and, by doing so, to detect any quantitative outliers. Consequently, prudential reporting is only one element the supervisor will use to assess IRRBB in his Supervisory Review and Evaluation Process (SREP) and to determine a possible Pillar 2 capital surcharge for this or to undertake other prudential actions (see Part 3 of this circular letter).

Hence, institutions are expected to manage their interest rate risk positions on the basis of both economic value and earnings sensitivity, and to do so in relation to different possible interest rate scenarios, including a persistently low interest rate environment.

The reporting obligations as described in Part 4 of this circular letter and enclosed in Annex 2 (reporting table 90.30) and Annex 3 (clarification of reporting table 90.30) apply to the institutions mentioned under the scope of this circular letter, unless the size of their banking book is *de minimis*, as defined in Part 2 of this circular letter. The reporting obligations are on a (sub-)consolidated basis. Additional reporting on a non-consolidated basis can be requested if the supervisor considers it necessary.

In order to calculate the data to be reported, the institutions follow their own internal methodology, taking into account the reporting requirements included in Part 4 of this circular letter. When doing so, they should use the interest rate scenarios set by the supervisor and standard assumptions for behavioural items such as savings and sight deposits. These standard assumptions are merely intended for reporting purposes and should not be perceived as assumptions to be used obligatorily by institutions for their own internal risk management. Likewise, the supervisor has no wish whatsoever to intervene in the individual institutions' reinvestment policy of said instruments in assets with an appropriate interest adjustment date. Institutions are expected to develop their own internal models to assess how the interest adjustment of these deposits is behaving. These internal models and their corresponding assumptions should be clearly documented and regularly revised. The non-interest-bearing equity, which is excluded from the prudential reporting on IRRBB, can be (partially) incorporated into the internal interest rate risk management of institutions as a long-term financing source so as to stabilise the income from interest-bearing assets that are financed by this equity.

Within the context of this circular letter and of its related reporting obligations, the following definitions apply:

'**Interest rate risk'** is the current and future exposure of an institution's profitability and capital to adverse interest movements.

The '**banking book'** is the whole of the institution's interest bearing assets that are not part of the trading book, including off-balance sheet positions with an already fixed interest rate and short-term Treasury positions outside the trading book. For the definition of trading book, see the prudential definition of trading book in CRR[1] Art. 4 Section 1 (86). Consequently, instruments held with trading intentions and the hedging of these positions pertain to the trading book. Thus, instruments not held for trading intentions and the hedging of these positions pertain to the banking book. The accounting treatment of the instruments does not play any part in this respect. Non-interest bearing assets (including the non-interest-bearing elements of an institution's regulatory capital) are not part of the banking book. Any interest-bearing elements of the institution's regulatory capital pertain to the banking book.

The '**economic value'** of the banking book is the algebraic sum of the prospective cash flows of the banking book's assets, discounted at the present rate (swap rate, see Section 4.2.2.3 of this circular) and in accordance with their interest rate maturity.

'**Interest income'** is the difference between interest income and interest expenses related to the banking book. However, for institutions using International Financial Reporting Standards (IFRS), the concept of interest income should be used in a broader sense, so as to also take into account the changes in the real value of the banking book's items that are handled via the profit-and-loss account.

Part 1: Qualitative assessment of interest rate risk in the banking book

1.1. When supervising and evaluating the efficiency of IRRBB management, the supervisor will mainly monitor compliance with the EBA guidelines[2], as well as with the relevant Basel Committee guidelines[3].

1.2. To do so, the NBB is adopting the EBA guidelines on interest rate risk in the banking book in full. The EBA guidelines include 5 general ones concerning:

1) the internal capital assigned to IRRBB, if appropriate on different levels of (sub-)consolidation as well as on a non-consolidated basis, as required by the competent supervisor and consistent with the level of application of the supervisory review and evaluation process

[1] Capital Requirements Regulation (CRR), that is Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No. 648/2012.

[2] EBA/GL/2015/08, "Guidelines on the management of interest rate risk arising from non-trading activities", 22 May 2015 (see Annex 1).

[3] Basel Committee on Banking Supervision, "Principles for the Management and Supervision of Interest Rate Risk", July 2004.

(SREP), which should be commensurate to IRRBB, measured by means of internal calculation methods;

2) the measurement of IRRBB, which should be based on both economic value and earnings sensitivity;
3) the different interest rate scenarios that consider changes in the slope and shape of the yield curve, as well as changes in the relationship between various yield curves (basis risk);
4) measures and guidelines on the internal governance with regard to IRRBB management and
5) the standard shock for prudential purposes, which must be reported to the supervisor in accordance with Article 98 (5) of Directive 2013/36/EU (CRD), transposed into Belgian law by Article 143, §1, 12° of the Banking Law.

More detailed guidelines are also provided concerning:

1) the different interest rate scenarios for the daily update of IRRBB as well as for stress testing;
2) assumptions regarding items with embedded behavioural optionality, such as non-maturity deposits or deposits with indefinite repricing term and the inclusion of non-interest-bearing assets;
3) different IRRBB calculation and evaluation methods;
4) governance of IRRBB and more specifically the relevant overall strategy, risk policies, processes and controls, the IT systems and data quality and the internal reporting and
5) the identification, calculation and allocation of the internal capital held for IRRBB.

The supervisor assumes that every institution, when outlining its policy, shall take these EBA guidelines on management of interest rate risk arising from non-trading activities into consideration and establish a documented and argued view on them that is adapted to the institution's specific circumstances, taking into account the proportionality principle below.

1.3. As a basic principle, the supervisor's review will take into account the assumption that the risk management of each institution should be adapted to the nature, size and complexity of the activities and the risks incurred. This is the so-called proportionality principle as entered in the EBA guidelines.

1.4. The review may lead to the conclusion that the institution should be regarded as a 'qualitative outlier', meaning that its risk management has significant shortcomings.

1.5. In principle, the supervisor expects IRRBB to be managed by the institution on both a (sub)consolidated and non-consolidated basis.

Within the context of IRRBB, an approach on a consolidated basis means, among other things, that an institution, as a parent company of a group, has a clear view on the scope of the total IRRBB of the entire group, as well as of the location within the group (parent company, individual subsidiaries) where those risks are situated.

The way in which the 'consolidated' IRRBB of the entire group is measured can be based on basic data actually 'consolidated for accounting purposes' to which an internal measurement method is then applied, but may also take the shape of an 'aggregation' of internal measurement results for the group's separate entities.

For the review of interest rate risk management by institutions belonging to a group, the supervisor also considers the dimension of the group in which interest rate risk management is based. Notwithstanding the fact that an institution’s interest rate risk management is based on the group's interest rate risk management policy, the institution concerned should develop suitable management practices on its own level.

1.6. For the quantitative outlier approach (see Part 2 of this circular letter), an institution subject to the reporting obligations set out in Part 4 of this circular should, moreover, be able to calculate, and to report to the NBB, the economic value and earnings sensitivity of the banking book in terms of economic value and in terms of interest income, on the basis of uniform assumed interest rate movements set by the NBB and of requirements concerning assumptions about the treatment of certain behavioural items.

Part 2: Quantitative assessment of interest rate risk in the banking book

The supervisor designs his prudential approach on the basis of a classification of the institutions according to whether their banking book is *'de minimis'* or relevant. Among the institutions with a relevant banking book a further distinction is made between institutions with moderate or significant IRRBB.

2.1. 'Institutions with a *de minimis* banking book' are those of which the size of the banking book is *de minimis* in relative and absolute terms.

More specifically, the banking book's size is regarded as *de minimis* if the total of the banking book items is normally less than 5% of the institution's total assets and is usually less than EUR 15 million. These thresholds are based on the provisions of Article 94 of the CRR, where *de minimis* thresholds are defined with reference to the size of the trading book.

2.2. 'Institutions with a relevant banking book' are all those institutions which do not meet the definition of institutions with a *de minimis* banking book.

2.3. 'Institutions with significant IRRBB' are institutions with a relevant banking book that hold significant interest rate risk positions with regard to their financial strength and that are considered to be quantitative outliers within the context of this circular letter.

More specifically and in compliance with Article 143, § 1, 12° of the Banking Law, measures should in any case be taken by the supervisor if it is shown that a sudden and unexpected change in interest rates would reduce an institution's economic value by more than 20 % of its regulatory capital, as stipulated in Part Two (Art. 25-91) of the CRR.

The supervisor's SREP for IRRBB also considers the institution's earnings sensitivity. The joint review of both economic value and earnings sensitivity for IRRBB may lead to the conclusion that the institution should be regarded as an institution with significant IRRBB.

2.4. 'Institutions with moderate interest rate risk in the banking book' are those institutions with a relevant banking book that do not meet the definition of institutions with significant interest rate risk in the banking book.

Part 3: Prudential measures

The supervisor's evaluation of IRRBB based on the principles and reporting described in this circular shall serve as the basis for the NBB's Supervisory Review and Evaluation Process (SREP) for those institutions designated as less significant within the Single Supervisory Mechanism (SSM), and shall also contribute to the ECB's supervisory review and evaluation process for the significant institutions directly supervised by the ECB since 4 November 2014.

3.1. Prudential action with regard to qualitative and/or quantitative outliers can consist of various possibilities, such as measures concerning:

- heightened vigilance;

- raising awareness among the effective management team and/or the supreme decision-making body of the institution;
- improving the internal organisation of the management of interest rate risk;
- improving the internal systems and the methodologies applied;
- improving internal monitoring;
- the size of the internal capital as referred to in Article 94 of the Banking Law;
- imposing internal limits;
- imposing provisioning;
- compulsory winding-down of risk positions;
- holding an additional regulatory capital margin as referred to in Article 149 of the Banking Law.

The nature of the prudential action to be taken (and so the choice to be made from one or more of the above-mentioned options) may depend on factors such as:

- the absolute and relative scope of the exposure to IRRBB (according to different interest rate scenarios);
- the exposure's possible impact on interest income in the next few years;
- the quality of the internal organisation of interest rate risk management;
- the quality of the internal systems and calculation methods used (among other things for the economic value of the banking book);
- the quality of the internal monitoring;
- the market segments in which the institution operates (such as the customer profile related to behavioural items);
- the relationship with other types of risk;
- peer group comparison; changes over time; benchmarking;
- the composition of regulatory own funds;
- the size of any regulatory own funds surplus;
- the composition and size of the internal capital allocated to IRRBB;
- the relationship between the size of internal capital and regulatory own funds;
- the relationship between the economic value of the banking book and its book value;
- the relative weight of interest income in overall profitability;
- the degree in which the standard assumptions on behavioural items set by the supervisor for reporting purposes are adapted to the real features of those items in the individual institution under review;
- the duration of own funds;
- the way in which the institution handles currency problems;
- the localisation, within the group's branches, of sufficient internal capital and regulatory own funds in the place where the risks (in this case IRRBB) are actually taken;

  etc.

Where appropriate, the assessment of these elements may also lead to the conclusion that, except for heightened vigilance and awareness-raising among the effective management team and/or the supreme decision-making body of the institution, no additional prudential action with regard to a qualitative or quantitative outlier needs to be taken.

3.2. In compliance with Article 94 of the Banking Law, all quantitative outliers, as any other institution, are in every way expected to actually hold sufficient internal capital for IRRBB.

In this respect, the internal capital allocation system should give heed to the possible impact of interest rate movements on both the institution's economic value and profitability in the next few years. It should also pay attention to the impact of non-parallel interest rate movements, changes in the relationship between different yield curves (basis risk) and the risk of a change in rating, currency or country-specific spread curves (credit spread risk).

Part 4: Reporting obligations

4.1. Reporting of internal calculations

Institutions with a relevant banking book shall keep a description and the necessary documents regarding their own indicators they use and report internally for the management of IRRBB, calculated according to internally defined methods, interest rate scenarios and assumptions, for economic value sensitivity on the one hand and earnings sensitivity on the other, at the disposal of the supervisor.

They also keep the periodic results of these indicators at the supervisor's disposal. If necessary, the supervisor may request individual institutions to report these results periodically to him outside the usual periodic reporting circuits.

4.2. Periodic prudential reporting obligations

Institutions with a relevant banking book are subject to the periodic reporting obligations as described in Sections 4.2.1 and 4.2.2 of this circular letter and in its Annexes 2 (reporting table 90.30) and 3 (comment on reporting table 90.30).

The adjusted XBRL taxonomy as well as the OneGate test environment for this adjusted reporting will be available in the course of November 2015. For more technical information on the OneGate reporting in XBRL-format we recommend you to consult the NBB website:
http://www.nbb.be/OneGate ► «Documentation» ► «Domain MBS – XBRL reports».

The NBB's prudential reporting requirements are in accordance with the EBA guidelines concerning the standard shock for prudential purposes, but in addition to information on economic value sensitivity based on economic value they also contain information on earnings sensibility based on interest income. Moreover, the NBB's requirements regarding periodic prudential reporting are more specific than the general EBA guidelines.

4.2.1. General requirements

1) The institutions follow their own internal methodology for the calculations, but in doing so, they should use interest rate scenarios set by the supervisor and standard assumptions for behavioural items such as savings and sight deposits. These standard assumptions are merely intended for reporting purposes and should not be perceived as assumptions to be used obligatorily by institutions for their own internal risk management. Likewise, the supervisor has no wish whatsoever to intervene in the individual institutions' reinvestment policy of said instruments in assets with an appropriate interest adjustment date.

2) Reporting table 90.30 is drawn up on a (sub-)consolidated basis. All bank subsidiaries and branches falling within the prudential consolidation scope should also be included in the consolidated prudential reporting on IRRBB, except for those entities that are insurance companies.

   Institutions with a relevant banking book that are not subject to consolidated supervision should report on a non-consolidated basis.

   An institution that reports reporting table 90.30 on a consolidated basis, does not have to report the table on a non-consolidated basis, except on explicit request by the NBB.

3) Although the interest rate risk associated with insurance activities, pension plans for employees or group insurance can be of a material nature, and should if necessary be duly monitored and managed by the institution, these activities shall not be included in the prudential reporting as the interest rate risk profile of these activities usually differs strongly from the other banking book positions.

4) With regard to the inclusion of the positions, see the above-mentioned definition of banking book. All trading book positions should be excluded. All banking book positions, except those mentioned under item 3), should be included, including short-term Treasury positions and all interest-bearing off-balance-sheet positions of a non-trading nature and with a pre-fixed interest rate. The inclusion of off-balance-sheet positions not only presumes the inclusion of amounts of funds borrowed but still to be delivered, but also the inclusion of loans granted but not yet paid out and of other commitments of the institution regarding the supply of fixed-interest-rate loans, including binding credit offers and credit lines with pre-fixed interest rate. The inclusion of these off-balance-sheet positions requires duly founded and documented assumptions or assessments regarding the fulfilment of these positions in the different scenarios. In this respect, reference is made to the proportionality principle, with the expected refinement of the assessments and models depending on the institution's size, the complexity of its activities and the materiality of the positions.

5) When calculating the economic value, interest income and economic value and earnings sensitivity, institutions should consider the value of all automatic options and the way in which their value changes in the different interest rate scenarios. Automatic options are to be understood as those options that will almost certainly be fulfilled if this is in the financial interest of their holder. Automatic options can be explicit options as well as options embedded in the characteristics of certain products. The impact of interest rate changes on the (intrinsic) value of these options should be fully covered in the reporting. Moreover, the proportionality principle is also applied here, with bigger and more complex institutions being expected to also take into account the time value of an option, when relevant. Institutions shall consistently adhere to a duly founded and documented policy about how they incorporate transactions of an optional nature (both specific option contracts and so-called 'embedded options') in the calculations according to the different scenarios.

6) Also regarding other behavioural optionalities (except for non-maturity deposits: see below), institutions should make the assessments themselves and incorporate them into the prudential reporting. The proportionality principle is applied with regard to the refinement of these assessments and models.

   For instance, the following should be taken into account:

   a) Early repayments

   The institution should take into account the loss of revenue due to early redemption or refinancing of mortgages or other loans for which the loss of margin must not be fully compensated by the customer.

   Taking into account early repayments should be done dynamically, with the expected number of early repayments (normally) being significantly lower in scenarios with an increasing interest rate than in the baseline scenario, whereas a significantly higher number of early repayments should be taken into account in falling interest rate scenarios.

b) Term deposits

Also for term deposits that can be withdrawn with only a partial remuneration of the costs incurred by the institution, these early withdrawals should be estimated and taken into account in the calculations of the economic value, interest income and economic value and earnings sensitivity, with the estimated early withdrawals varying according to the scenario.

7) All hedged positions and hedging operations pertaining to the banking book should be included in the prudential reporting, since the reporting should not only reflect a correct assessment of the economic value and earnings sensitivity, but also a correct assessment of the economic value and interest income. In addition, a hedging instrument can barely be used to cover both economic value and interest income.

8) Non-interest-bearing assets and equity elements are not part of the banking book and should therefore be excluded.

9) Commercial margins should be included in the calculation of the economic value and interest income. In other words, cash flows should be included at external customer rates. As the inclusion of commercial margins can increase the economic value sensitivity of institutions with large commercial margins, the institutions can, additionally and on a voluntary basis, also report the economic value, excluding the commercial margins, therefore at swap rate on production/repricing date(except for non-maturity deposits, which should be included at external customer rates).

10) The table is reported in euros, for the entire banking book. In accordance with the Basel Principles of 2004[4], a separate calculation should be made for each currency in which the positions exceed 5% of the non-trading assets or liabilities. Consequently, positions in different currencies in which such material positions are held, cannot be simply compared, as this would presume that interest rates in the different currencies are perfectly correlated. For each currency in which the positions exceed 5% of non-trading assets or liabilities a separate calculation of economic value and earnings sensitivity should be made. Subsequently, only losses (in economic value and interest income) in the foreign currency are taken into account and are added to the results in euros in each of the scenarios. Positions in currencies that are less than 5% of non-trading assets or liabilities should be converted into euros and should be included in the calculations in euros. The cumulative outcome should be reported in table 90.30.

11) In the simulation of interest rate shocks, prudential reporting takes into account a floor interest rate of 0%. Negative interest rates should be replaced in the calculations of the different scenarios by an interest rate, being the minimum of 0% and the (negative) interest rate of the instrument in the basis scenario of unchanged interest rates

12) Reporting frequency is quarterly.

4.2.2. Economic value sensitivity

Institutions should be able to provide information on the economic value of their banking book calculated according to their own internal methodology and considering the requirements mentioned under 4.2.1, but in doing so, they should use - for the purpose of the outlier approach - set interest rate scenarios and standard assumptions for behavioural items such as savings and sight deposits.

The proportionality principle is applied for the calculation of economic value sensitivity. More specifically,

4 Basel Committee on Banking Supervision, “Principles for the Management and Supervision of Interest Rate Risk”, July 2004.

bigger and more complex institutions are expected to make the calculations on a 'full revaluation' basis. Small and modest institutions can make the calculations on a 'duration' basis.

In particular, the calculations of economic value sensitivity in terms of economic value should meet the following requirements:

4.2.2.1. Assumptions for behavioural items

For the treatment of savings and sight deposits, institutions shall use the following required assumptions concerning the interest rate adjustment date:

- interest-insensitive sight deposits (ordinary sight deposits with very low (or no) interest remuneration which is not associated with market interest rate movements): interest rate adjustment after five years;
- interest-sensitive sight deposits (sight deposits whose interest rate is being adjusted fully and immediately to market interest rate movements): immediately adaptable interest rate;
- semi-interest-sensitive sight deposits (sight deposits with an interest remuneration which, although higher than the remuneration for interest-insensitive sight deposits, does not change immediately and fully along with market interest rate movements): interest rate adjustment after two years;
- regulated savings deposits (savings deposits that meet the conditions as stipulated by Art. 2 of the Annex to the Royal Decree of 27 August 1993 implementing the Income Tax Code 1992): interest rate adjustment after two years.

Consequently, the deposits concerned should be repriced entirely on the above-mentioned interest rate adjustment date.

The supervisor shall regularly inspect these uniform assumptions concerning the interest rate adjustment date of savings and sight deposits and adjust them if necessary - still for reporting purposes - by means of a circular letter.

4.2.2.2. Interest rate scenarios

Besides the scenario of unchanged interest rates, the calculations follow six stress scenarios of immediately implemented standardised assumed parallel interest rate movements: three parallel interest rate rise scenarios and three parallel interest rate fall scenarios. The scope of the standardised assumed parallel interest rate movement in the different scenarios amounts to 100, 200, and 300 basis points respectively.

Depending on the prevailing interest rate environment, the most appropriate interest rate movement at that time of those three assumed interest rate movements will be used in the 'outlier' detections process. In principle, the scenario of a 200-basis-point interest rate movement will be used, but, taking into account the prevailing interest rate environment and particularly the level of interest rates and their observed volatility, the supervisor can opt for the use of another reported scenario. For his choice, the supervisor will test, among other things, to what degree the chosen scenario is in keeping with the 1° and 99° percentile of observed interest rate movements, using a minimum of five years of observation and a one-year holding period. If the 200-basis-point interest rate movement turns out to be smaller than this observed interest rate movement, the latter will be used in the 'outlier' detection process.

4.2.2.3. Discount rate

Institutions are to use a plain vanilla swap rate as discount rate, for instance with the overnight, 3 or 6 months rate as a floating leg. For positions with a repricing term lower than the shortest available fixed leg of the applied swap curve, the institutions should use the prevailing interbank rates. These rates should then be converted into zero coupon rates in order to obtain the discount rate.

4.2.3. Earnings sensitivity

With regard to interest income and earnings sensitivity, it should be noted that in line with the above-mentioned definition of interest income, the concept of interest income should be used in a broader sense for institutions using IFRS, so as to also take into account the changes in fair value that are handled via the profit and loss account.

At the same time, the basis for the calculation of interest income in the baseline scenario and in the stress scenarios should be the same as the one for the calculation of interest income of the past 12 months, which should be reconcilable with interest income in FINREP.

In particular, the calculations of earnings sensitivity in terms of interest income should meet the following requirements:

4.2.3.1. Assumptions for behavioural items

The institution uses the following assumptions concerning the interest rate adjustment date of behavioural items:

- interest-insensitive sight deposits: interest rate adjustment after five years;
- interest-sensitive sight deposits: immediately adaptable interest rate;
- semi-interest-sensitive sight deposits: interest rate adjustment after six months;
- regulated savings deposits: interest rate adjustment after six months.

The supervisor shall regularly inspect these uniform assumptions concerning the interest rate adjustment date of savings and sight deposits and adjust them if necessary - still for reporting purposes - by means of a circular letter.

4.2.3.2. Interest rate scenarios

Besides the scenario of unchanged interest rates, the calculations follow six stress scenarios of gradually implemented standardised assumed parallel interest rate movements: three parallel interest rate rise scenarios and three parallel interest rate fall scenarios. The scope of the standardised assumed parallel interest rate movement in the different scenarios amounts to 100, 200, and 300 basis points respectively.

The different scenarios of parallel interest rate movements assume gradually implemented interest rate movements, one quarter of which is adjusted immediately, one quarter after three months, one quarter after six months and one quarter after nine months.

For semi-interest-sensitive sight deposits and regulated savings deposits, the institution bases itself on assumed interest rate movements which amount to only 70% of the standardised assumed interest rate movements. Consequently, an interest rate rise of 200 bp would mean that for regulated savings deposits (with a 6-month interest rate adjustment date) an interest rate increase of 105 bp is taken into account after 6 months (75%*200bp*70%) and an additional 35 bp after 1 year (25%*200 bp*70%).

4.2.3.3. Assumptions for the interest rate to be applied on repricing

In order to calculate the expected interest income result over the next 3 years in the baseline scenario (unchanged interest rates), institutions should apply, for new positions replacing positions which have come to maturity (see Section 4.2.3.4 below), the spot interest rate for customers on the reporting date (swap rate and commercial margin on reporting date). For existing positions that are repricing, the spot swap rate on the reporting date plus the historic commercial margin should be applied in the baseline scenario. In order to calculate the interest income result among the different stress scenarios, the relevant interest rate shocks should be applied on these spot interest rates.

4.2.3.4. Assumptions for the replacement of positions coming to maturity (static balance sheet)

Calculations concerning interest income should be based on a static balance sheet, with the current balance sheet composition being maintained over the surveyed horizon of 3 years, and the positions coming to maturity being replaced by similar positions ('replacement growth'). Since the initial maturity of individual positions cannot always be discovered, 'replacement growth' can be applied on a portfolio level. The division into different portfolios should, however, be sufficiently granular (at least per type of product), with a clear distinction between, among other things, mortgage loans to households, consumer loans, investment loans to large enterprises, investment loans to SMEs, cash credit, interbank claims, hedging transactions, etc.

The total portfolio volume should remain constant. For each portfolio, the institutions should replace positions coming to maturity (both balance-sheet and off-balance-sheet items, within the 3-year horizon for interest income) by new positions, with the repricing term of these new positions reflecting the current production for this portfolio. The average repricing term for each portfolio should remain as constant as possible. If this should strongly change the average repricing term of that portfolio, then this should be motivated and documented sufficiently and be forwarded to the supervisor.

On the basis of the reported data, the supervisor can calculate additional indicators, for instance in relation to other profitability data of the institution.

A copy of this circular letter will be forwarded to the supervisory director(s), certified auditor(s) of your institution.

Yours faithfully

J. Smets
Governor

<u>Annexes</u>:

1 *EBA Guidelines of 22 May 2015 on the management of interest rate risk arising from non-trading activities*

2 *Reporting table 90.30*

3 *Comment on reporting table 90.30*

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