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Circular

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

Scope

This circular is applicable to credit institutions under Belgian law, institutions equivalent to settlement institutions and financial holding companies, which are hereinafter referred to as "the institutions".

The principles and criteria mentioned herein with regard to the supervisory review and evaluation process essentially apply on a consolidated as well as on a non-consolidated basis.

Summary/Objectives

With effect from 31 December 2019, this circular shall replace Circular NBB_2018_32 on sound management practices and reporting concerning interest rate risk arising from non-trading activities and shall transpose the guidelines of the European Banking Authority (EBA) of 19 July 2018 on the management of interest rate risk arising from non-trading book activities into the Belgian prudential framework.

Dear Sir,
Dear Madam,

In accordance with Articles 142 and 143 and Articles 7 and 8 of Annex I of the Law of 25 April 2014 on the legal status and supervision of credit institutions (hereinafter ‘the Banking Law’), this circular clarifies the principles and criteria on which the NBB bases its supervisory review and evaluation process concerning the management and hedging of interest rate risk arising from an institution’s non-trading activities (hereinafter ‘interest rate risk in the banking book’ – IRRBB). This circular replaces circular NBB_2018_32 on sound management practices and reporting concerning interest rate risk arising from non-trading activities.

The supervisory review and evaluation process takes into account both qualitative (adequacy of the institution's risk management) and quantitative (level of the risk actually incurred) concerns about IRRBB. The supervisor's evaluation of IRRBB on the basis of the principles and reporting described in this circular shall, as such, serve as the basis for the NBB's Supervisory Review and Evaluation Process (SREP) for institutions identified as less significant within the Single Supervisory Mechanism (SSM), and shall also contribute to the ECB's SREP for significant institutions, which are under the ECB’s direct supervision since 4 November 2014. Moreover, the reporting described in this circular shall serve as the basis for the evaluation of the interest rate risk in the Belgian banking sector by the NBB as macroprudential authority.

The supervisor adopts the entirety of the guidelines of the European Banking Authority (EBA) of 19 July 2018 on the management of interest rate risk arising from non-trading book activities (hereinafter referred to as “the EBA Guidelines”), as included in Annex 1, and specifies additional requirements with regard to the reporting obligations.

It should be stressed that IRRBB is still regarded as a Pillar 2 risk and should as such be adequately managed, evaluated and capitalised internally, whereas prudential reporting aims to compare IRRBB across different institutions and, by doing so, to detect any prudential outliers. Consequently, the prudential reporting is only one of the elements which the supervisor will use to assess IRRBB in his Supervisory Review and Evaluation Process (SREP) and to determine a possible Pillar 2 capital surcharge or take other prudential action for this purpose (see Articles 149 to 154 of the Banking Law).

1. EBA guidelines on the management of interest rate risk arising from non-trading book activities

When supervising and evaluating the efficiency of the management of interest rate risk arising from non-trading activities, the supervisor will mainly monitor compliance with the EBA guidelines[1] and with the relevant Basel Committee standards[2].

For this purpose, the NBB adopts the entirety of the EBA Guidelines of 19 July 2018 on interest rate risk arising from non-trading book activities The EBA Guidelines consist of 6 main sections:

1) Determination of the subject, scope and definitions. The current Guidelines also cover credit spread risk, in contrast to the EBA Guidelines of 2015. For institutions with SREP categories 3 and 4, the requirement to monitor and assess credit spread risk is postponed until 31 December 2019.
2) General requirements
3) Identification, calculation and allocation of the internal capital assigned to IRRBB, which should be commensurate to IRRBB as measured according to internal calculation methods, taking into account both economic value and earnings sensitivity.
4) Measures and policies on internal governance in relation to IRRBB management.
5) The calculation of IRRBB, which should be based on both economic value and earnings sensitivity, on the basis of different shock and stress scenarios taking account of changes in the slope and shape of the yield curve as well as of changes in the relationship between various yield curves (basis risk), including the six prescribed shock scenarios, namely (1) a parallel increase, (2) a parallel decrease, (3) a steeper interest curve, (4) a flatter interest curve, (5) an increase in short-term interest rates, and (6) a decrease in short-term interest rates. Guidelines are also provided on the calculation and monitoring of interest rate risk resulting from derivative positions.
6) The supervisory outlier test, which must be reported to the supervisor in accordance with Article 98(5) of European Directive 2013/36/EU (CRD), transposed into Belgian law by Article 143, §1, 12° of the Banking Law.

The supervisor expects that every institution, when outlining its policy, takes these EBA guidelines on the management of interest rate risk arising from non-trading book activities into consideration and establishes a well-reasoned and documented view on them that is adapted to the nature, size, complexity and risk profile of the institution’s activities.

In principle, the supervisor expects IRRBB to be managed by the institution on both a (sub-)consolidated and a non-consolidated basis. Within the context of IRRBB, an approach on a consolidated basis implies inter alia that an institution which is a parent company of a group has a clear view on the scope of the entire group’s total IRRBB as well as on the location of those risks within the group (parent company, individual subsidiaries).

The way in which the 'consolidated' IRRBB of the entire group is measured, can be based on baseline 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 the interest rate risk management of institutions belonging to a group, the supervisor also considers the group dimension of the interest rate risk management. 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.

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

1 EBA/GL/2018/02, “Guidelines on the Management of interest rate risk arising from non-trading book activities”, 19 July 2018 (see Annex 1).

2 Basel Committee on Banking Supervision, “Standards: Interest rate risk in the banking Book”, April 2016.

2. Reporting obligations

2.1. Reporting of internal calculations

Institutions shall keep a description and the necessary documents regarding their own indicators, which they use and report internally for the management of IRRBB as 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 shall also keep the periodic results of these indicators at the supervisor's disposal. If necessary, the supervisor may ask individual institutions to report these results periodically to him outside the usual periodic reporting circuits.

2.2. Periodic prudential reporting obligations

2.2.1 Institutions classified as significant within the SSM

1) As from reporting date 31 December 2019, institutions classified as significant within the SSM are no longer required to submit the NBB's specific reporting in table 90.30. From then on, the NBB will use the ECB reporting tables, which these institutions are to report on a quarterly basis with regard to IRRBB in the context of the ECB's Short-Term Exercise (STE).
2) In order to be able to form an adequate view of all Belgian institutions' interest rate risk, the Belgian subsidiaries of institutions that are considered significant within the SSM, which until now had to submit no or only a limited reporting to the ECB, will also be required, from reporting date 31 December 2019 onwards, to provide the entire ECB STE reporting on IRRBB, including all underlying positions, on a quarterly basis. For institutions equivalent to settlement institutions, the supervisor may decide on an individual basis that these reporting requirements shall not apply to an institution if its non-trading activities are de minimis[3] or if the supervisor has assessed the interest rate risk arising from that institution's non-trading activities to be sufficiently mitigated to justify a derogation from the reporting obligations.
3) The reporting should be prepared on a (sub-)consolidated basis. Institutions that are not subject to consolidated supervision (as a parent company) should report on a non-consolidated basis.
4) The reporting deadline has been made to correspond with the reporting deadlines set by the ECB for this reporting.

2.2.2 Institutions classified as less significant within the SSM

Institutions classified as less significant within the SSM are subject to the periodic reporting obligations described in points 2.2.2.1, 2.2.2.2 and 2.2.2.3 and in annexes 2 (reporting table 90.30) and 3 (explanatory notes to reporting table 90.30) of this circular. For institutions equivalent to settlement institutions, the supervisor may decide on an individual basis that these reporting requirements shall not apply to an institution if its non-trading activities are de minimis or if the supervisor has assessed the interest rate risk arising from that institution's non-trading activities to be sufficiently mitigated to justify a derogation from the reporting obligations.

2.2.2.1 General requirements

1) Institutions follow their own internal methodology for the calculations but should use the interest rate scenarios and specifications set by the supervisor for the calculations as included in section 4.5 of the EBA Guidelines on the supervisory outlier test, as well as the additional NBB specifications described below.
2) Reporting table 90.30 should be prepared 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-

[3] Non-trading activities are considered to be de minimis in scope if their total normally does not exceed 5% of the institution's total assets or amount to more than € 15 million. These thresholds are inspired by the provisions of Article 94 of the CRR, which defines de minimis thresholds in relation to the size of the trading book.

consolidated basis. Institutions that report reporting table 90.30 on a consolidated basis are not required to report the table on a non-consolidated basis, except at the explicit request of the NBB.

3) The reporting frequency is quarterly, with reference dates 31 March, 30 June, 30 September and 31 December. The first reporting in accordance with this circular should relate to the situation on 31 December 2019. The periodic reporting should be submitted as soon as possible and, at the latest:

On a non-consolidated basis: on the first working day of the second calendar month following the reporting date. When the reporting date coincides with the balance sheet date, the reporting should relate to the situation after the proposals of directors to the board of directors or the managers have been processed.

On a consolidated basis: two months and 15 days from the reporting date. Reporting statements at the end of the financial year should be submitted no later than when the (accredited) auditor(s) in charge of auditing the consolidated annual accounts are or should be aware of the statements needed to prepare their written report; however, this date may not be later than three months from the reporting date.

The adapted XBRL taxonomy and the OneGate testing environment for this modified reporting will be available in October 2019. For more technical information on the OneGate reporting in XBRL format, please visit the NBB website: http://www.nbb.be/OneGate> «Documentation» > «Domain MBS – XBRL reports».

2.2.2.2 Economic value sensitivity

Institutions should be able to provide information on the economic value of their banking book as calculated according to their own internal methodology and considering the general requirements mentioned under 2.2.2.1 and the additional specifications and uniform assumptions included in sections 2.2.2.2.1 to 2.2.2.2.4.

Economic value sensitivity is calculated using the proportionality principle. More specifically, larger and more complex institutions are expected to make the calculations on a 'full revaluation' basis. Small and simple institutions can make the calculations on a 'duration' basis.

2.2.2.2.1 Inclusion of commercial margins

By way of derogation from the EBA Guidelines, commercial margins should be included in the calculation of the economic value. 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, institutions can, on a voluntary basis, also report the economic value excluding commercial margins i.e. at swap rate on production/repricing date (except for non-maturity deposits, which should be included at external customer rates).

2.2.2.2.2 Interest rate adjustment dates for deposits without a contractual maturity

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

§ interest-insensitive sight deposits (ordinary sight deposits with very low (or no) interest rates which are not linked to market interest rate movements): interest rate adjustment after five years;

§ interest-sensitive sight deposits (sight deposits of which the interest rate adapts fully and immediately to market interest rate movements): immediately adaptable interest rate;

§ semi-interest-sensitive sight deposits (sight deposits with interest rates which, although higher than the interest rates for interest-insensitive sight deposits, do not adapt fully and immediately to market interest rate movements): interest rate adjustment after two years;

§ regulated savings deposits (savings deposits that meet the conditions stipulated by Article 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 for savings and sight deposits and adjust them if necessary - for reporting purposes - by means of a circular.

2.2.2.2.3 Interest rate scenarios

In accordance with the EBA Guidelines, the calculations follow six stress scenarios of immediately implemented standardised assumed interest rate movements, in addition to the scenario of unchanged interest rates: a parallel increase in interest rates with 200 basis points, a parallel decrease in interest rates with 200 basis points, a steepening yield curve, a flattening yield curve, a rise in short-term interest rates and a fall in short-term interest rates (see Annex III of the EBA Guidelines for the four non-parallel interest rate scenarios). Only the parallel increase and decrease in interest rates are taken into account for the outlier approach. According to the EBA Guidelines, the other four scenarios should be reported for the purpose of the additional outlier test, which serves as an early warning indicator.

2.2.2.2.4 Discount rate

Institutions are to use a plain vanilla swap rate as discount rate, with e.g. 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 to obtain the discount rate.

2.2.2.3 Earnings sensitivity

With regard to earnings sensitivity, account should be taken of not only the impact on the interest result, but also the changes in fair value that are handled through the profit and loss account or directly through the own funds (via “other comprehensive income”). In accordance with the EBA Guidelines, commercial margins should always be included in the interest result.

Additionally, the interest result in the baseline scenario and in the stress scenarios should be calculated on the same basis as the interest result of the past 12 months, which should be reconcilable with the interest result in FINREP.

In particular, the calculations of earnings sensitivity in terms of interest result should take into account the general requirements included in section 2.2.2.1. and should, in particular, meet the following requirements:

2.2.2.3.1 Interest rate adjustment dates for deposits without a contractual maturity

The institution uses the following assumptions with regard to the interest rate adjustment date for deposits without a contractual maturity:

§ 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 for savings and sight deposits and adjust them if necessary - for reporting purposes - by means of a circular.

2.2.2.3.2 Interest rate scenarios

In addition to the scenario of unchanged interest rates, the calculations follow six stress scenarios of gradually implemented standardised assumed parallel interest rate movements: a parallel increase in interest rates with 200 basis points and a parallel decrease in interest rates with 200 basis points.

These scenarios 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 relies on assumed interest rate movements amounting to only 70% of the standardised interest rate movements. Consequently, an interest rate rise of 200 bp would mean that, for regulated savings deposits (with interest rate adjustment after six months), account is taken of an interest rate rise of 105 bp after 6 months (75%*200bp*70%) and of an additional 35 bp after 1 year (25%*200 bp*70%).

2.2.2.3.3 Assumptions for the interest rate to be applied on repricing

In order to calculate the expected interest result over the next 3 years in the baseline scenario (unchanged interest rates), institutions should, for new positions replacing maturing positions (see section 2.2.3.4 below), apply 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 result among the different stress scenarios, the relevant interest rate shocks should be applied on these spot interest rates.

2.2.2.3.4 Assumptions for the replacement of maturing positions (static balance sheet)

Calculations with regard to the interest result 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 established, '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 maturing positions (both balance sheet and off-balance sheet items, within the 3-year horizon for interest result) with new positions; the repricing term of these new positions should reflect the current production for this portfolio. If this strongly changes the average repricing term of that portfolio, this should be sufficiently motivated and documented 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 will be forwarded to the (accredited) auditor(s) of your institution.

Yours faithfully,

Pierre Wunsch
Governor

Annexes-only available at www.nbb.be:

1. EBA Guidelines of 19 July 2018 on the management of interest rate risk arising from non-trading book activities
2. Reporting table 90.30
3. Explanatory notes to reporting table 90.30