IBSM Solutions
Integrated Balance Sheet Management Solutions, Inc.

Integrated Balance Sheet Management Solutions, Inc.
1267 Dorval Drive, Unit 36
Oakville, ON L6M 3Z4
Canada
+ (416) 388-3079

BCBS - revised standards for Interest Rate Risk in the Banking Book.

On April 21, 2016 the BCBS published the revised standards for IRRBB, which set out supervisory expectations for banks' identification, measurement, monitoring and control of IRRBB as well as its supervision.

Recognizing the difficulties in developing a standardized IRRBB approach that is both accurate and risk sensitive, the BCBS has implemented an enhanced Pillar 2 approach (i.e. not linked to minimum capital requirements). It will apply to large internationally active banks on a consolidated level (with national discretion for subsidiaries of those and/or non-internationally active banks), and is expected to be implemented by 2018.

Some highlights:

- Greater Guidance in terms of shock and stress test scenarios, modelling approach and internal validation process; including the possibility to mandate a standardized framework if internal systems fail to capture IRRBB effectively.

- Risk Measures will include impact on Net Interest Income (NII), change in Economic Value of Equity (EVE), computed based on a prescribed set of scenarios, as well as Credit Spread Risk in the Banking Book (CSRBB).

- Required Capabilities: IRRBB will need to be integrated with the broader risk management framework, be flexible, forward looking and aligned with its business/capital planning and budgeting activities (changes in balance sheet composition). In low rate environments, scenarios should also consider the impact of negative interest rates.

- Limits should be set based on the nature, size, complexity and capital adequacy of the bank, and could include sub-limits for individual business units, portfolios, instruments, as well as for gap risk, basis risk, and/or optionality. Regulators will single out Outlier Banks defined (as a minimum) as those with Economic Value sensitivity above 15% of Tier 1 Capital (under the prescribed scenarios).

- Assumptions: fully document key behavioral and modelling assumptions on optionality (prepayments, pipelines, early redemption), non-maturity deposits, treatment of own equity, etc.

- Model Governance and Data Requirements: stricter data quality, documentation and control requirements (i.e. RDARR), including systems, models and market inputs provided by vendors.

Integrated Balance Sheet Management Solutions, Inc.
1267 Dorval Drive, Unit 36
Oakville, ON L6M 3Z4
Canada
+ (416) 388-3079

- Disclosure requirements: including EVE and NII sensitivity under prescribed methodology (e.g. constant balances, rolling 12 month window), scenarios and formats, as well as qualitative information on exposure, assumptions, IRRBB objectives and management.

- Enhanced Regulatory Review of IRRBB practices: with the potential to require additional capital and/or other mitigation actions if deemed excessive.

What does this mean for F.I.s?

An enhanced Pillar 2 approach is probably the best outcome given the significant difficulties in establishing a common approach across markets. National Regulators will have the ability to complement/tailor the BCBS guidelines to their specific markets and obtain meaningful benchmarks across local institutions.

- Many F.I.s will need to update their existing risk management framework, policies, procedures and IRRBB models to comply with the new regulatory expectations. Specifically Balance Sheet and NII modelling capabilities will need to update (e.g. static gap based metrics will no longer be sufficient), and have e significant flexibility, e.g. to accommodate ad-hoc regulatory requirements using different scenarios and/or assumptions and measuring IRRBB across the different dimensions (NMD, optionality, etc.). The standardised framework could serve as the guideline (minimum requirement) to develop internal IRRBB capabilities.

- In order to benefit from potential synergies from leveraging and integrating IRRBB requirements to other on-going initiatives such as RDARR, capital planning (ICAAP) and IFRS-9, F.I.s will require a comprehensive view of internal and regulatory risk management requirements and intersections across the multiple dimensions (not an easy task).

- Compliance will require further integration and improved coordination across the Treasury, Risk Management, Finance (Capital / Budgeting) and Audit areas in order to meet expectations.

- Governing Bodies (e.g. Board of Directors, ALCOs) are expected to have an in-depth understanding of IRRBB (e.g. risk exposures and drivers, key model assumptions) on the existing book, as well as the impact on them from new business initiatives.

Please contact us if you require assistance in developing / implementing your IRRBB framework.