

## Prometeia supports over 10 banks on ECB IRRBB 2017 stress test

May 2017

The European Central Bank sensitivity analysis of **Interest Rate Risk in the Banking Book (IRRBB)**, the **supervisory stress test required for 2017**, is still on its way, with the quality assurance phase running until end of May. Yet debate is already open on the challenges and the operational burden it poses on banks.

Prometeia, the global leader in Risk Management consulting and software solutions, is supporting over ten customers in the **reporting production and the quality assurance phase** using its proprietary ALM system, ERMAS.

The goal of the ECB is to collect thorough information on the exposure of supervised institutions to non-traded market risk, in order to detect **potential vulnerabilities** to specific interest rate scenarios and complete the SREP assessment for IRRBB.

**Relevant information will not just be quantitative**, referring to potential negative impacts both on EVE and on NII, **but also qualitative**, meaning that ECB will also consider data availability, timeliness, and the quality of information provided in order to assess internal governance, risk management effectiveness and system adequacy.

From a methodological point of view, the exercise refers to both *EBA Guidelines on the Management of IRRBB*, and the *2016 BCBS Standards on Interest Rate Risk in the Banking Book*, from which the six shock scenarios are derived. Reading between the lines, given the short notice period and considering that BCBS standards have not yet been codified in European law, it seems that the **ECB is trying to understand whether banks would be ready to comply with the new principles**, and which specific methodological issues or approach might better fit European banks' business models.

But what are the real challenges for risk managers in this exercise? It depends on the state of each bank's individual risk management framework, ALM internal approach and systems capabilities.

A summary of **main issues tackled**:

- › **NII and EVE** – Sensitivity analysis is requested for both EVE and NII measures, consistent with international guidelines, in order to capture the different dimensions of interest rate risk;
- › **Negative rates scenarios** – The six scenarios, derived from the BCBS standards, include parallel and non-parallel shifts, as well as downward shifts into deeply negative territory. This represents a new challenge for IRR analysis and potentially a challenge to ALM systems and, ultimately, risk measures;
- › **Legal (zero) floor** – The negative rates scenarios raise the issue of a sound assessment of the impact of contractual and legal zero floors embedded in banking book instruments such as customer loans and deposits. The exercise not only measures the impact of such floors in the NII and EVE

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measures, but also examines the impact of including and excluding them, as required for non-maturity deposits (NMDs);

- › **Behavioral models assumptions** – Given the relevance of behavioral modelling in IRRBB, a strong focus is given on the contribution to interest rate risk measures of NMDs and prepayment models, as well as any other behavioral model internally developed by banks, which should provide risk measures applying both modelling assumptions and contractual conditions;
- › **Breakdown for banking book interest rate derivatives and bond portfolios** – Banks are required to provide a breakdown of IRRBB measures so that the contribution of micro/macro hedge derivatives could be assessed, as well as that of AFS, FVO and HTM bond portfolios;
- › **Commercial margins** – Banks are required to provide EVE measures, *if available*, both including and excluding commercial margins from cash flows. This one issue has been explicitly addressed by the BCBS standards and will probably be under discussion within the revision of IRRBB regulation in Europe.

Thanks to **ERMAS**, Prometeia's flagship risk management platform, all figures and breakdowns required in the exercise are readily available, given the **completeness and granularity of input data** (including FTP and risk-free rates at origination for each deal), the **analytical capabilities**, and the **high flexibility of the system configuration and output drill down**.

ERMAS, the new generation of value-centric risk solutions, is used by over 200 clients in more than 20 different countries to support their critical decisions and to comply with local and international regulatory requirements.

To find out more, visit [www.prometeia.com](http://www.prometeia.com) or [contact us](#).

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*With over 40 years of experience in economic research, quantitative analysis and model development, Prometeia is a global provider of consulting services and software solutions focused on Risk, Performance & Wealth Management. With over 700 industry experts, we serve more than 200 financial institutions in 20 different countries, through a consolidated network of foreign branches and subsidiaries located in Europe, Africa and the Middle East*