

# Managing IRRBB to stabilize a Bank's Earnings and Capital Base

Why the BCBS enhanced Pillar II approach for Interest Rate Risk Banking Book could send the wrong signals

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## Introduction

More than a decade has passed since the 'Principles for the Management and Supervision of Interest Rate Risk' were first published by the BIS Committee back in 2004. Recently in April 2016, and after much consternation from the original consultation document, the finalized Standards for IRRBB were released. The principal highlight, to the relief of the majority of banks was the dropping of a regulatory Pillar I capital charge to cover IRRBB, to be replaced with a more 'enhanced' Pillar II approach. On the face of it, this major concession is a significant win for banks, but it should not be underestimated the challenges an 'enhanced' Pillar II approach will bring, both operationally and strategically; and in particular whether disclosure of the IRRBB regulatory metrics will send the correct signals to external stakeholders. Furthermore the finalized standards do not shy away in recommending further action (including additional capital requirements) against banks where it is demonstrated there are inherent weaknesses in their qualitative and quantitative processes.

In preparation for the 2018 deadline, what are the key elements of an implementation strategy banks need to be cognizant of that will result in an unambiguous, well contextualized and informed view of how it manages its IRRBB?

### Highlights of BCBS Finalized Standards IRRBB

- » To be implemented by 2018
- » Pillar 1 approach advocated in previous Consultation Document (CD) has been dropped
- » Replaced with Enhanced Pillar II principles based approach
- » Alternative prescriptive Standardized Framework approach can be adopted or mandated by supervisor
- » Quantification IRRBB – via economic (▲EVE) and earnings (▲NII) based metrics
- » IRR Principles of 2004, updated to reflect the changes in market environment
- » Banks to broaden stress testing programs, including incorporating six prescribed regulatory scenarios, negative interest rates - better understand impact on IRRBB
- » Assess, manage and report Credit Spread Risk Banking Book (CSRBB) – no clear guidance provided by BCBS
- » Imperative that critical behavioral and modeling assumptions are scrutinized, validated and understood by senior management
- » Onerous disclosure requirements – frequency, transparency, consistency to help aid comparability between peer groups
- » IRRBB models – subjected to robust, fully audited model governance process
- » Failings in banks' management of IRRBB – capital consequences, forced move to the standardized approach

- » Impact of regulatory interest rate shocks on EVE must not be greater than 15% of Tier 1 Capital, previously threshold set at 20% - 'outlier / materiality test'

## Regulatory Backdrop

Back in April 1993 the BIS sought industry feedback on its consultation paper, which discussed principles for managing interest rate risk. Not surprisingly it faced industry resistance back then, but eventually the final 13 principles were adopted and adhered to. Post the 2007 global financial crisis, the BCBS placed the management of interest rate risk under greater scrutiny. Fast forward to 2015 and that lengthy review culminated in the Committee issuing its Consultative Document -d319, where the overarching recommendation was that IRRBB should be covered by Pillar 1 or by a more rigorous enhanced Pillar II approach. According to the Committee its pursuance for a Pillar 1 charge was twofold: 1) namely to ensure banks had adequate capital to cover potential losses that arose due to changes in interest rates and 2) (in light of the BCBS's Fundamental Review of the Trading Book) to reduce the opportunities for regulatory capital arbitrage between the banking and trading book.


In October 2015 the EBA published its Pillar II principle based technical guidelines on IRRBB and finally, in April 2016, (post the Consultative period), the BCBS issued its finalized Standards for IRRBB as an enhanced Pillar II approach. Nevertheless, the consideration of IRRBB as a Pillar II risk is not deemed a general consensus; the Australian Prudential Regulation Authority (APRA) applies a Pillar 1 capital requirement for IRRBB to those banks that have an advanced accreditation for credit risk and operational risk, effective since 1 January 2008.

The BCBS in its endeavors to reduce the global systemic risk of a future financial crisis believes there is not enough accurate analysis that allows a sufficient comparison of the risks faced by banks. To address this challenge the Committee has put forth regulatory IRRBB disclosure templates, which it hopes will make it easier to compare the key metrics of changes in Net Interest Income (NII) and Economic Value Equity (EVE) published by banks across all regions. To ensure consistency, the disclosures will be driven by a set of prescriptive interest rate scenarios, such that the Committee hopes to end up with an 'apples to apples' comparison. The jury is still out on the merits and feasibility of undertaking this industry comparative review and whether it exposes too much detail of how a bank positions and hedges its balance sheet, to the benefit of its competitors.

Ascertaining the robustness of a bank's IRRBB governance framework probably means local regulators will need to go further during their 'bank audit' visits and assess the quality and depth of policies, effectiveness of procedures and processes, including model validations. Not an easy task, but essential when evaluating the veracity of the IRRBB metrics. Where any of these qualitative aspects are deemed less than satisfactory, the regulator could utilize these control factors as ingredients to additional outlier /materiality tests.

## Banks' Strategic Concerns of the BCBS IRRBB Finalized Standards

- » There are reservations that the enhanced Pillar II approach will expose too much detail of how a bank positions and hedges its balance sheet by virtue of what can be gleaned and interpreted from the range of EVE sensitivities under each prescribed interest rate scenario. Some banks complain that disclosure of all the regulatory interest rate scenarios could reveal useful intelligence about a bank's balance sheet duration, thus disadvantaging its hedging strategy
- » Exclusion of Equity from EVE disclosures, create and exacerbate a re-pricing mismatch as equity investments will appear to be unfunded and unhedged. There is a real risk that investors and analysts could misinterpret EVE disclosures on a 'going concern' basis, thus overstating the risk, particularly for longer duration portfolios, when viewed under higher interest rates. To set the right context in this highly non-normalized interest rate environment, disclosure discussions with external stakeholders will need to be carefully managed to obviate any



confusion the bank is somehow over exposed to interest rate risk vs. its peers. The delicacy of these discussions will be further hampered by the freedom to use a range of risk-free rates, which can either include or exclude commercial margins to discount cash flows to derive the EVE. Another headache is investors may question the bank's equity investment strategy, its duration and its risk profile.


- » On the funding side, Table A Quantitative disclosures section of the finalized standards require banks to provide details of the average and longest re-pricing maturity for Non-Maturity Deposits (NMDs). Such details, when viewed together with the high level assumptions underpinning those deposit pools, provide competitors insight to a bank's deposits strategy including pricing.
- » With global interest rates unlikely to rise at an accelerated pace in the near future, one could argue that banks' behavioral deposit and prepayment models are influenced less by interest rates vs. other contributing factors. Viewing the standardized framework of the finalized standards, the BCBS expects an indicator of deposit stability to be evidenced through ten years of historical data. From this historical data set, it would be intriguing to see what conclusions could be drawn when comparing the zero interest rate behavior of recent years vs. pre-global financial crisis.
- » The finalized standards permit and recommend local supervisors supplement the standard 'outlier' test with other materiality tests, which are predicated on a set criteria (to be defined and published by the supervisor) and subsequently applied to identify an outlier bank that is running excessive IRRBB. For banks operating in multi-jurisdictions, there is a prospect overseas regulators could apply via their IRRBB programs, a local punitive outlier / materiality test, way more stringent than the 15% threshold. Failing this test would subject the overseas entity (bank) to adjust its risk profile or seek further support from head office. Without knowing the supervisory criteria to distinguish outlier banks, banks will need to tread carefully and consider a range of EVE sensitivities under different internally calibrated stress scenarios, which could see the decline in EVE greater than 7.5% and 10% of Tier 1 capital. The local supervisor could also broaden the scope of an outlier test to evaluate the sensitivity of EVE to an alternative capital measure as well as considering the implications of IRRBB from earnings volatility. Obvious as it may be, no bank wants to be labeled or published as an outlier (or ranked as closely to becoming one) during normal market conditions, let alone during a market stress, where the permutations of how the stress unravels are unknown.

## Operational Challenges for Banks

If we utilize the definition of IRRBB as per the BCBS Finalized Standards, "IRRBB refers to the current or prospective risk to a bank's capital and to its earnings, arising from the impact of adverse movements in interest rates on its banking book", the key theme one could argue is that the emphasis is primarily obtaining a forward view of the risk as accurate as possible, and how the impact of the risk could crystallize in such a way to the detriment of the bank.

Under the purview of the banking book, the ability to exploit a balance sheet mismatch by virtue of borrowing short and lending long via a favorable interest rate environment has become that much harder. Banks accept that although IRRBB is a risk that has been managed and reported to a certain degree from day one, they now realize it will need to be much more aggressively assessed, planned for and continuously calibrated within their Risk Appetite Framework, in order to maintain their competitiveness in this tough market.

Despite the relaxation from a Pillar I to an enhanced Pillar II approach, the challenge for banks will be obtaining the level of transparency required for providing a set of unified consolidated IRRBB metrics that clearly illuminate the underlying risk drivers and how they dynamically impact the bank's IRRBB profile. Under the finalized standards, banks are compelled to undertake regular, more comprehensive reviews and simulations of their balance sheet strategies. Additionally it is essential a bank safeguard the alignment between its policies, model assumptions, data and computational processes and final regulatory reporting metrics. Any disconnect between them would raise question marks on the integrity of the bank's overarching risk management framework and potentially could lead to the regulator imposing some further measures.



Deriving a consolidated view of its IRRBB could be an onerous task, particularly for large international banks, where it is not unusual for overseas units that operate under a decentralized model to make frequent adjustments to their Asset Liability Management (ALM) metrics, therefore better reflecting the nuances of the local market, but on the downside it ultimately results in excessive local customization of the ALM solution. If for some reason there is less than adequate documentation at the local business unit level explaining these customizations, it could lead to inconsistencies in how glossaries, business rules, models and reporting are managed across the group.

To trace how IRRBB metrics have been derived requires a high level of granularity across the computation process. IRRBB metrics are considered calculation intensive and repetitive, most tools perform aggregations or in-memory calculations that skip intermediate steps meaning the details of the calculations are not maintained and cannot be viewed. In order to be compliant with the traceability and transparency requirements, intermediate calculations have to be stored and should remain available for auditing. In a systemically important financial institution (SIFI), this means that a scalable, robust functional architecture should be in place for creating global scenarios, and calculating and consolidating IRRBB results in a consistent way, across different jurisdictions, currencies and business models of a group.

Furthermore the management of IRRBB should be supported by a strong Models Governance Framework, whereby models are maintained and calibrations reviewed regularly, and their methodologies documented to be reported and discussed with the national supervisor. For the past 10 years, modeling activities have been mainly related to Credit Risk Assessment, so the modeling platform is usually functionally and technically separated from the ALM platform, which generates methodological issues for maintaining and calibrating behavioral models, especially when interest rate is a factor.


During the Global Financial Crisis banks faced a liquidity crunch such that for some banks the only viable option to avoid a collapse was to seek refuge in the form of a merger. With mergers completed, coupled with an easing of the gridlock in the wholesale funding markets, the operational challenges for consolidated balance sheet management became more evident for the primary reason each institution often had different legacy systems, which operated under distinct methodologies for aggregation, limit monitoring and behavioral models. Trying to establish coherent and informative IRRBB metrics under the merged entity becomes more complex and often will take considerable resources, both time and effort wise to rectify the underlying issues.

One of the most dramatic paradigm shifts in the way banks compute and report IRRBB, is the requirement expressed by the BCBS, via the final Standards, to separately analyze the interest rate components for IRRBB; with no limitation to a “Risk Free Yield Curve” anymore. Although market spread analysis has always been a part of the ALM perspective, this represents a specific challenge for banks in a context of extremely low or negative interest rates, since those spreads sometimes represent the most important part of the customer rate itself.

Finally, let’s not forget to mention the critical data challenge presented by the enhanced Pillar II approach. IRRBB assessment requires banks to load all existing contracts and positions together with customer data that will help to stratify and document the behavioral assumptions applied. To validate any interpretations of this assessment, there should be consistency and commonality between the data ingested by ALM, Credit, Liquidity Risk and Funds Transfer Pricing solutions and therefore reinforces the need for a global risk and finance data governance framework.

## Evolution Towards Transparency and Integration is Required

Over the years, ALM has evolved from a static point-in-time analysis to a more strategic, more forward looking behavioral and dynamic view. With improvements in ALM tools, computational performance, and refinements in ALM policies & processes many banks, both large and small, appreciate the benefits of being able to draw coherent



conclusions on a more frequent basis from a micro based representation of the balance sheet compared to the historically opaque view offered by the general ledger.

In order to deliver on the new IRRBB standards, today's ALM infrastructure has to provide both greater precision and transparency, in an architected and automated way, providing financial institutions with all the detailed documented rules and calculations at all stages of the process. Ideally a bank should run the process at a granular level, leveraging all the available shared data of the organization to provide a holistic view of the balance sheet.

Delving deeper into the details of the finalized standards, banks would appreciate the importance of being able to apply some form of dynamic rules framework, which captures and assigns exposures deemed to be amenable and non-amenable to standardization.

The same framework should support the bank in tracking the transient nature of deposit classifications. For example the aggregated deposits of a small business customer that fluctuate above and below EUR 1million due to currency volatility (assuming the customer holds multi-currency accounts) and / or absolute balance movements could lead to a different classification on any given reporting date.

On the asset side, a bank will be compelled to isolate those loans across its geographies that legally attract pre-payment charges vs. those that don't. Again careful consideration to how these loans will be filtering and classified should be housed under a broader rules regime.

## Modeling and Simulation Processes

Modeling activities were traditionally performed in separated environments based on specific extractions that were not aligned with the ALM production data most of the time. Such an approach necessitated it to be revisited and reviewed.

Model governance is part of the regulatory requirements for IRRBB and financial institutions need to control, calibrate and document their models, keep track of the data used and ensure a comprehensive data governance framework exists.

In the digital age and depending on the products, the customers' behavior can be highly sensitive to interest rates and other economic variables. With a lower loyalty rate and the use of mobile deposits acquiring significant market shares, deposit behavioral models require frequent review and update. On the asset side, customers with superior credit ratings are afforded facilities to renegotiate, prepay or reschedule their obligations; therefore ALM assumptions have to be adjusted frequently based on a range of sophisticated patterns and risk factors.

Given the benign interest rate outlook, competitive market pressures, and highly prescriptive regulatory environment, the ability to extract a few additional basis points in net interest margin (NIM) from the banking book is becoming extremely difficult. To help address this, a bank should look to improve its operational efficiencies in its modeling, scenario building and analytical reporting processes. By integrating these key disciplines, the bank, in principle, will be able to identify an initial market opportunity and quickly assess its viability by leveraging a centralized modeling framework, which shares the outputs of the model seamlessly with the current balance sheet profile, thus giving a rapid view whether the opportunity is deemed P&L positive or not. ALCOs in their mandate to manage the balance sheet and deliver shareholder returns, expect such analysis to be available in real-time. However unless modeling cycles, scenario and impact analysis are shortened then capitalizing on any such window of opportunity becomes less likely.





## Reviewing and Aligning Interest Rate Components

Greater flexibility in yield curve modeling for IRRBB will impact the Transfer Pricing framework

Traditionally, IRRBB had always been assessed using a risk free rate benchmark. With the European sovereign debt crisis, this paradigm has been questioned, and progressively entity or instrument-specific spreads have been included as a best practice in the yield curves construction process to better reflect the dynamics of the banking book. Taking this approach for internally assessing IRRBB is encouraged by the EBA guidelines and further reinforced by the finalized BCBS Standards, where it is permissible for the incorporation of 'commercial margins' and 'other spread components' when deriving the 'risk free rate' that will be applied to discount balance sheet cash-flows.

This makes it compelling for ALM tools to accommodate advanced yield curve modeling features that give the ability for banks to create and easily maintain hybrid curves that reflect the merging or adding of spreads to market curves. In addition, this facilitates deeper understanding of specific interest rate components, their temporal structure, how they affect product / customer profitability and valuations, both under a business-as-usual and stressed perspective.

It also requires unifying funds transfer adjustments used for management control with the IRRBB rate components as well as using FTP systems in a forward looking mode, so that the forecast impact of interest rate scenarios can be distributed across the organization, products and segments in accordance with budgetary and targets monitoring.

## Economic Value Approach Is No Longer The Main Driver For Setting Limits Anymore

With very low or negative interest rates, preserving earnings is becoming an art in itself

For capital adequacy purposes, the most important approach had always been to assess the consequences of interest rate shocks on the economic value of the banking book, in the same way as for the trading book. This impact was mostly assessed statically, discounting the expected run-off cash flows with a range of stressed yield curves. This value based measurement can be interpreted as closer to a gone concern approach, since the underlying assumption is predicated on the bank's ability to liquidate its group balance sheet at a unique point in time, which in itself, problematic and quite unrealistic.

Today, with margins getting slimmer and competition becoming more intense from the arrival of the new 'challenger' banks, it is not surprising comments received after the BCBS consultation reinforced the fundamental differences not just between the banking and trading book, but also the heterogeneity of business models across bank peer groups. Also, it is worth noting there is an acceptance of the importance of assessing the impact of interest rate shifts on an ongoing basis and dynamically renewing maturing assets and liabilities when economically wise to do so.

## Re-evaluating the ALM Framework

As regional regulators clarify local IRRBB requirements, banks have an opportunity to re-architect their ALM infrastructures and integrate it within broader Corporate Management Information Systems, so as to gain a new level of transparency and global strategy simulation capabilities, which can significantly improve their competitive positioning.

Considerations to keep in mind when planning for a next-generation ALM framework:

» **Revisit approaches and methodologies that measure embedded optionality**

In light of the finalized IRRBB standards, it makes good business sense to take a fresh look at existing deposit behavioral and pre-payment models and make a formal appraisal of the underlying assumptions. Do the models reflect the unique dynamics of today's market and how would they fare under a more 'normalized' rising yield curve outlook. For example, is there a clear scenario that indicates that a proportion of the vast pools of low cost retail deposits acquired by Tier 1 banks are likely to evaporate? If yes, would this be an indiscriminate outflow or defined by some other factors? Should a bank tag deposits that sought a flight to safety during the crisis as 'hot money' or are they part of the new 'core' and thus are appropriately re-priced? Arguments can be made for both classifications, but whatever the decision; there must be strong empirical evidence, backed up by scenario and sensitivity analysis to support the findings.

» **Validate with ALCO that they have a complete appraisal of the risks faced by the balance sheet**

Discuss whether the IRRBB metrics produced as part of the current ALCO report provide the appropriate insights that bear out the potential ramifications for liquidity and capital. For example what does a volatile EVE bode for the paths of LCR and NSFR? What other analysis should be undertaken, is it clear that for a set of internal plausible stress scenarios, how the bank would continually fund and hedge itself?

» **Evaluate the significance of the new IRRBB requirements alongside other Basel III obligations on how effectively the bank can progressively optimize its balance sheet or parts thereof**

Not surprisingly, managing the balance sheet today to deliver healthy returns, which is an art in itself, has become that much more difficult, especially with all the regulatory and internal constraints. The analytical and governance burdens are so great today, that not enough resources are available to be totally dedicated to 'value creation' activities.


Despite this, opportunities may present themselves to allow banks to exploit certain activities to help optimize certain balance sheet metrics. If we take stock of how funding models will operate in the future, it is inevitable that there will be a concerted push to optimize the returns on those funding pools. However extracting a few additional basis points will be constrained by regulatory, market, and management considerations. For example, optimizing incremental NIM will be weighed up against economic value of the investment profiles of the deposits, whether there are specific balance sheet limits, which require a certain liquidity profile to be adhered to, given the deposit behavior run-off under a FTP process and how this ultimately impacts the LCR and NSFR.

» **Are the costs of embracing the standardized framework vs. the enhanced Pillar II approach well understood?**

On the face of it, a bank logically would want to avoid the constraints and prescriptive nature of the standardized framework, but for some institutions there may not be enough concrete historical data to support meaningful analysis of how much embedded optionality exists in the balance sheet, or there is very little evidence to suggest otherwise. Another explanation for going down the standardized route is the absence of advanced tools and applications to undertake the quantitative investigations required under the Principles of the enhanced Pillar II approach. Whatever the reason for not taking the Principles based approach it would be useful to approximate (if possible) what the incremental cost of hedging the balance sheet would be. Furthermore a bank should broadly accept that adopting the standardized framework will reveal more sensitive details how it positions its balance sheet due to the prescriptive constraints, which limit the use and flexibility of internal models.

» **How informative is the current forecasting analysis and does it play a real tangible role in the balance sheet planning process?**

Consistent with driving the ALCO forward and challenging its opinions of how the balance sheet and earnings would evolve (or not), ALM analysts should present clear guidance on the trajectory of earnings under a multitude of views. The succinct analysis in itself should provide the narrative of where the risks reside under each scenario, in particular the interplay of how economic conditions could sway customer behavior and the implications of if and how the bank will continue to fund and hedge the balance sheet and at what cost. In some respects, the impact of scenarios in themselves should be viewed heterogeneously to reflect that certain balance sheet actions / strategies may not be viable due to the nuances of the bank's business model, the market environment is no longer conducive to accommodate the bank's balance sheet needs due to lack of access or prohibitive costs or a combination of all the above. Having a matrix view of the balance sheet and earnings



projections under each scenario vs. those key behavioral metrics and how they evolve gives ALCO a fuller context when deciding the best strategies that could be executed to obviate further risks, whilst simultaneously preserving profitability.

» **Data Governance**

Given the numerous disparate source systems that proliferate across a bank, banks have realized that implementing a robust data governance framework is a major undertaking since it requires an overhaul of procedures, processes and how data overall is managed. Similar to other regulatory requirements, the BCBS IRRBB Standards demand and expect data consistency across the behavior modeling cycle, as well as for ensuring the accuracy of any simulations. Historically data sets ingested by and produced by ALM, Market Risk, Credit Risk and Liquidity Risk applications were typically housed in their respective silos, with little appreciation that aspects of data commonality could reap broader benefits, by way of providing a holistic view of the balance sheet and the risks it faced. In a post Basel III world, emphasis on the quality of the data management frameworks and how data is reconciled between source systems, computation engines and final regulatory reports is just as important as the final regulatory filing. To achieve this coherent aligned view, many banks are now embarking on risk and finance transformation programs, where a unified data model that serves both business disciplines ensures the bank can confidently state it has an accurate single source of data that serves its key analytical requirements.

» **Accept that the ALM process is an integral part of the bank survival toolkit**

With the need to deliver IRRBB at a consolidated level, banks should seek to establish closer ties between ALM, Regulatory Liquidity Risk Management, Capital Planning and Stress Testing, so as to deliver consistent metrics at any level of consolidation and across the different lines of business geographies and currencies.

» **Move away from a static view and make it a BAU activity to evaluate the impact of alternatives scenarios on earnings and profitability**

Under current market conditions, and taking into account supervisors' priorities, the management of IRRBB is evolving from a *gone concern* to a *going concern* view. It means that the focus is put on margin simulation, using regulatory and internal scenarios. Since banks are under pressure to reduce the time to market to launch new products, the banking portfolio can evolve rapidly, and the assumption of IRR metrics measured under a constant volume and structure assumption is not sufficient anymore. Dynamic simulations have to be automated and calibrated so as to become a standard recurrent process that should include not only market scenarios but business evolutions as well. If done efficiently it should provide the bank tangible value, to how retail products are priced optimally to deliver superior returns.

» **Review ALM and FTP systems as two views of the same mechanism:**


Banks that are able to fully incorporate the costs of managing IRRBB into their FTP operations will better align their profitability targets and risk appetites, and make it easier to test and execute strategic decisions. This way, internal income and risk allocation will be consistent with the evolution of market rates and their distribution into interest rate components, so the whole organization will dynamically contribute to improve profitability. The integration of ALM processes with FTP mechanisms will help detect non-profitable activities before they result in real losses.

» **Target to document all methodologies and approaches that support the assessment of IRRBB**

Make sure all the intermediate computations are available and documented and avoid in-memory no reversible aggregations or calculations that would be difficult to reproduce. The same discipline needs to be applied for each metric that is output by the ALM system. Special attention should be paid to tracking changes to any processes, model assumptions, calculations, regulatory updates and limits that would affect the accuracy of any IRRBB metric and thus need to be filed at detailed level and adequately documented.

## Conclusion

The finalized IRRBB Standards could be viewed as giving interest rate risk and how it is managed much greater prominence than previous and one could argue its importance now justifies sufficient public disclosure of certain sensitive measures. Apart from the disclosure requirements, there is a real effort by the BCBS to emphasize the



importance of getting much greater clarity of what drives the underlying assumptions of the bank's internal critical behavioral models and how it would seek to secure its franchise under a wide range of stress scenarios. A key theme is the implicit understanding that at each juncture of a stress scenario, the bank has a grasp what and how customer responses would be to a change in the economic or market environment and the likelihood of occurrence.

Despite the BCBS no longer advocating a Pillar 1 capital charge for IRRBB, it does not mean that banks should equate the enhanced Pillar II approach as 'business as usual'. Operationally banks will need to generate granular, detailed cash-flow information at greater frequency, coupled with a re-appraisal and in some cases re-haul of internal models across its different jurisdictions to assess whether they are still fit for purpose. Special attention must also be given to developing a far more robust governance framework that ensures confidence in all operational aspects that produce IRRBB analysis that is shared with ALCO.

A bank, failing to manage IRRBB in a less than adequate manner for a host of reasons both quantitatively and qualitatively is sufficient grounds for a local supervisor to impose some uncomfortable penalties plus be given the unfortunate title of an 'outlier', which will create uncertainty and confusion and is something to be best avoided. However, with no Pillar 1 charge required, banks are expected and should take advantage of this regulatory easing to make a far deeper assessment of how IRR is viewed and discussed internally, such that any market opportunities are much more easily identified and can be realistically maximized to deliver continued returns or offset potential risks.







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