EUROPEAN CENTRAL BANK

BANKING SUPERVISION

Sensitivity analysis of IRRBB – Stress-test 2017

Media briefing conference call

28 February 2017

Background & Objectives

Background

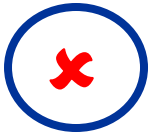
- **Art. 100 CRDIV** requires that competent authorities (CAs) conduct at least **annually supervisory stress tests** on the supervised institutions **as an input to the SREP**
- EBA Guidelines leave **room for Competent Authorities to follow different approaches**
- Next EU-wide stress-test will be conducted in 2018

⇨ The ECB will follow a different **approach to carry out** the annual supervisory **stress-test for 2017, focused on IRRBB**

Objectives

- Objective of the call is to **inform the media of the launching of the exercise**

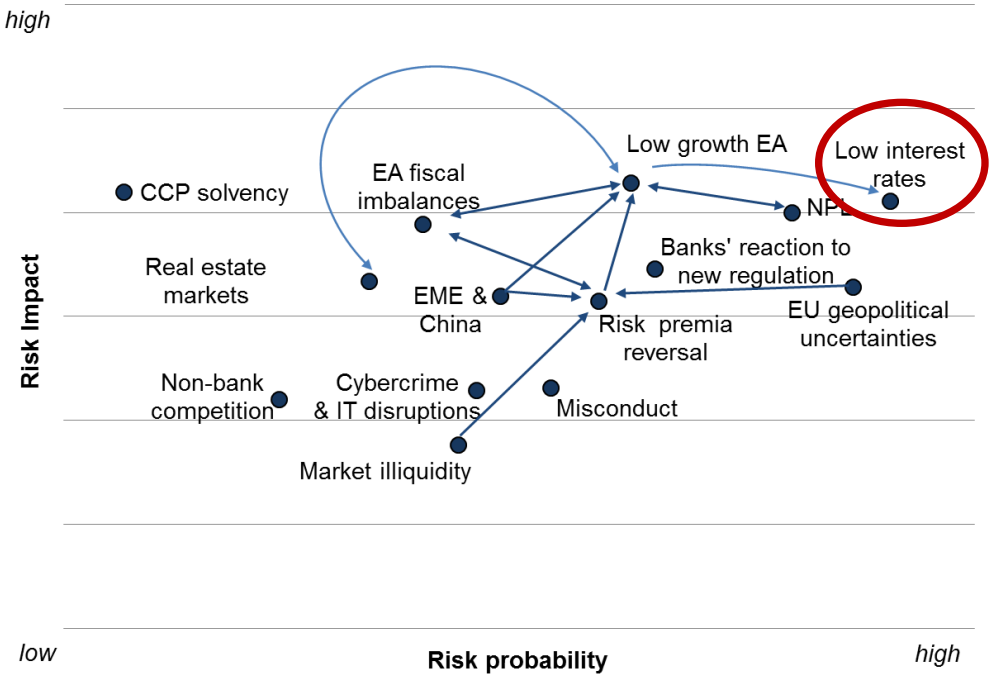
- Provide an **overview of the exercise and the approach**
- Present the foreseen **interactions between the banks and the ECB**
- Explain the **next steps**



- Discuss bank-specific information

After years of low rates, banks' exposure to interest rate risk is to be assessed

Key risks for SSM Banks



- **Low interest rates ease banks' funding** conditions.
- They can however exert **pressure on net interest margins.**
- In the low rates environment, **changes in customers' behaviors** already impacted the **balance sheet structure** on EA aggregate level, challenging the management of interest rate risk in the banking book.

Source: ECB. Arrows indicate potential transmission channels from one risk driver to another (only main first order effects are represented); NPL: this risk driver is only relevant for euro area banks with high non-performing loan (NPL) ratios.*

Interest rate risk in the banking book has been selected to carry out 2017 supervisory stress test.

Sensitivity analysis of IRRBB – Stress-test 2017 (2/3)

Advantages of a sensitivity analysis of IRRBB for the annual supervisory stress-test

- Addresses a **key risk** identified by SSM as a **priority for 2017**
- **Follows-up on the SSM risk analysis conducted in 2016**
- **Bottom-up component** (i.e. banks provide own projections) would **foster** the development of **banks' risk management capabilities**
- **Closes gap with** respect to previous **EU-wide exercises**
- Focusing the exercise on a **single risk** profile **lowers the burden for SIs** compared to 2016

SSM Supervisory stress-test for 2017

Objectives

- Assess the **vulnerabilities** of SIs **to various heuristic interest rates shocks**
- **Contribute to the overall SREP** to ensure SIs' capital adequacy, as well as sound risk coverage and internal processes.
- Ensure a **consistent treatment** of all SIs supervised by the SSM

Key Features of the Sensitivity analysis of IRRBB

Key features

- ~ **110 significant institutions *** are required to **report bottom-up projections** for the stress test period (**2017 – 2019**) based on year-end 2016 data
- Reported data will be **challenged by the ECB Banking Supervision**:
  - Assessments of IRRBB metrics related to both changes in **Economic Value of Equity** and **Net Interest Income projection;**
  - Assessment of quantitative figures complemented by **qualitative information** for a broader assessment of banks' risk management practices
- Exercise involves **6 hypothetical Interest Rate shocks** applied at the beginning of the observation period
- **Smaller exercise than 2016** (~700 data points vs ~ up to 200.000 in 2016)

Timeline

- The exercise will be **launched on 28th February**
- **Integration** of results **into the SREP**
- The **press and the public** will be **informed** in due course over the progress of the exercise

(*) Combined number of SIs included in the sample does not equal total number of SIs under SSM supervision, as some exceptions apply (e.g. SIs that are subsidiaries of other SSM SIs, already covered at the highest level of consolidation).

Risk dimensions of IRRBB will be tested according to two complementary approaches

EVE* changes related to several interest rate shocks

(instantaneous shock)

- Including overall impact of ALM modelling assumptions on EVE changes
- Including contribution of banking book derivatives to EVE changes

NII changes related to several interest rate shocks**

(3-year time horizon)

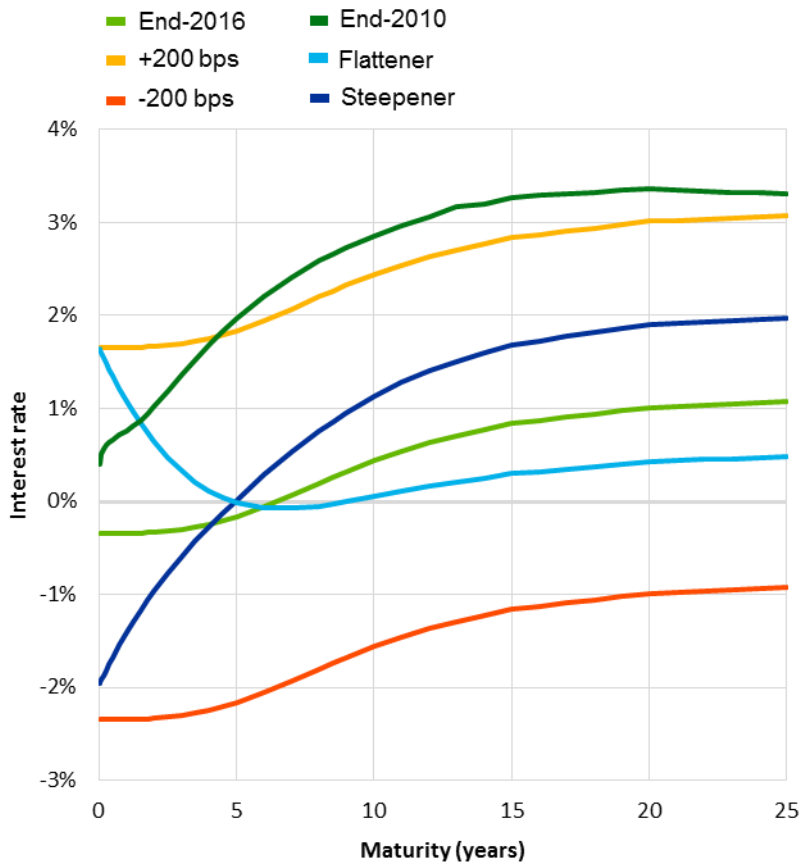
- Including overall impact of the main ALM modelling assumptions on NII projections
- Including contribution of banking book derivatives to NII projections

Assessment of quantitative figures will be complemented by qualitative information to inform the broader assessment of banks' risk management practices

** EVE: Economic Value of Equity*

*** NII: Net Interest Income*

Multiple interest rate shocks will allow exploring potential vulnerabilities in several directions



The interest rate shocks are heuristic and purely hypothetical. They do not reflect monetary policy considerations.

Suggested IR shocks complement the regulatory +/- 200 bps shocks in many ways:

- The *steepener* and *flattener* shocks have been calibrated following BCBS methodology
  - *Steepener* → ongoing trend in the long end of the curve in conjunction with a compression in short term rates
  - *Flattener* → A shock similar to the one related to the 2008 Lehman episode, e.g. inversion of the curve
- End-2016 → impact of a low rate for long starting line
- Back-to-2010 → a return of IR environment before the acute phase of the Euro Area crisis
- Shocks have been calibrated for major non-EUR currencies as well

Integration in 3 channels while avoiding double-counting between P2G and P2R

1. **Quantitative impact of interest rate risk on the EVE* as informative factor to potentially adjust up or down the level of 2016 P2G (no mechanistic translation of effect into P2G, but informed by the relative vulnerability of the banks to the different interest rates shocks in the exercise)**

2. **Qualitative information gathered on banks' risk management to be used for the assessment of the internal governance and risk management (SREP Element 2)**
   - Assessment of data availability, timeliness and quality – like in 2016

3. **Quantitative impact of interest rate risk on NII to enrich other elements of the SREP assessment**
   - Enrich and inform the Business Model Assessment (SREP Element 1)
   - Enrich and inform IRRBB Assessment (SREP Element 3: Risk to Capital)

It is expected that aggregate supervisory capital demand – all else being equal – for all banks will not increase.

High level timeline for the Sensitivity analysis of IRRBB – stress-test 2017

Data Collection	Quality Assurance	Computation of results and integration into the SREP
28th February – 5th April	April - June	July
ECB distributes data templates (28st February)	Ongoing interaction between **ECB** and **banks** ▪ requests for clarification ▪ data updates	Stress Test results feed into the **SREP**
Banks deliver full data set (5th April)		

DISCLAIMER

This presentation was developed based on the knowledge available at the point in time, when the content for this presentation was developed. Changes might apply in the future.