V.1, 14 December 2018

Interest Rate Risk in the Banking Book – Frequently asked questions

The HKMA has received a number of questions related to the new local framework for Interest Rate Risk in the Banking Book (IRRBB) which is based on the IRRBB Standards issued by the Basel Committee on Banking Supervision (BCBS) in April 2016. To help ensure a consistent implementation of this new framework, the HKMA provides a set of answers to frequently asked questions (FAQs), which may be updated over time.

Item	Question	Answer
1	Can an AI whose local/overseas subsidiaries are insignificant in terms of the size of total assets and liabilities exclude these from the consolidated IRRBB return?	It is possible to exempt certain insignificant subsidiaries from the scope of the consolidated IRRBB return. An AI can contact its supervisor to apply for such an exemption, provided that the aggregate notional positions (the interest-rate sensitive positions on the assets or liabilities side of the balance sheet, whichever is larger, plus off-balance sheet interest rate-sensitive positions) of all the relevant subsidiary entities do not account for more than 5% of its total consolidated notional interest rate-sensitive positions on the assets or liabilities side of its balance sheet, whichever is larger. The HKMA will consider approval on a case-by-case basis, having regard to the specific circumstances of the applicant AI. An AI that has been granted such exemptions would potentially be considered as an outlier if its IRRBB exposure exceeds 14% of its Tier 1 capital.
2	Which products are in scope for the IRRBB framework? Are credit card receivables, nostro and vostro accounts in scope?	All products not excluded in paragraph 10 of the IRRBB Return Completion Instructions are in scope. Products in scope therefore include credit card receivables, nostro and vostro accounts.
3	Does the HKMA waive the	The BCBS standards do not feature materiality thresholds. Therefore AIs must assess all interest

	need to address optionality for products that are not material to the overall IRRBB profile of the AI?	rate-sensitive assets and liabilities to monitor and report their interest rate risk.
4	How should AIs treat the optionality in managed rate products like prime rate loans?	The following is the reporting procedure for floating rate mortgages subject to prime rate caps: 1. report the mortgage as a managed rate asset if the prime rate cap is binding, and as a floating rate asset otherwise. The optionality can be ignored for the purpose of calculating the EVE impact. 2. when reporting the basis risk section (item 19 on the IRRBB return), AIs should take into account the effect of the prime rate cap – see the Completion Instructions of the IRRBB return for details.
5	What is the time span of data that needs to be used for behavioural analysis of NMDs?	For behavioural modelling of NMDs, AIs should always use 10 years of data if such data exist in their systems. An AI should notify its supervisors if the relevant data available to an AI extend to a period of less than 10 years but equal to or greater than 7 years. Such an AI should continuously extend its relevant database to cover at least 10 years and use all existing data to model NMDs in the interim period. An AI should contact its supervisors for approval if the data available to an AI extend to a period of less than 7 years and the AI intends to use such data for identifying core deposits. In considering granting the approval or not, the HKMA will assess whether the relevant assumptions and results adopted by the AI are prudent, including for example, whether the AI can demonstrate that its assumptions and results are similar to those of peer AIs which have sufficient data history and

		similar firm-specific characteristics of expected customer behaviour, and that the assumptions and results are sufficiently realistic under stress scenarios. The AI should continuously extend its relevant database to cover at least 10 years.
6	How does the interest rate floor, used for the ΔEVE and ΔNII calculations, affect interest rate shocks?	Application of the −2% floor slightly differs between assets and liabilities: On the asset side the risk-free rate is floored at −2%. AIs taking spreads into account add this spread to the floored risk-free rate. On the liability side the sum of the risk free rate plus the negative spread (if taken into account) is floored at −2%. This approach is reflected in paragraph 5.3.2 of the SPM. For example, if the risk-free yield in the time bucket 'Next day or less' before the parallel downward shock is −0.1%, then applying the formula from paragraph 5.3.2 of the SPM results in a post-shock interest rate of −2%. That is, the floored shock in the time bucket 'Next day or less' is −1.9%.
7	How should AIs investigate Credit Spread Risk in the Banking Book (CSRBB) within the IRRBB framework and which products are in scope for CSRBB?	In line with Section 1.4 in the Annex of the BCBS standards on IRRBB, in particular Figure 1 on p. 34, AIs must assess CSRBB for items at fair value, that is, for example, debt securities. It is the AI's responsibility to develop a suitable methodology for CSRBB.
8	Does the HKMA provide yield curves used in the IRRBB framework? How can AIs construct the yield curve used in the IRRBB framework?	The HKMA does not provide AIs with risk-free yield curves because these differ by currency and tend to change over time. It is the responsibility of AIs to construct appropriate yield curves based on the market conditions of individual currencies.
9	Can on- and offshore Renminbi	There still can be significant divergence between CNH and CNY interest rates, as could be observed

	be treated as a single currency in the IRR reporting template?	in the last couple of years, and therefore CNH and CNY should be reported separately for the time being.
10	At which frequency does the HKMA expect AIs to measure and monitor IRRBB?	AIs should measure their IRRBB at least quarterly and monitor their IRRBB exposure on a continuous basis. Whether an AI needs to measure its IRRBB more frequently (on an ongoing basis, or specifically after certain events) will depend on the information it gathers from the continuous monitoring process (e.g. whether the information has any material impact on the AI's IRRBB) and the buffer between the IRRBB exposures and the AI's internal IRRBB exposure limit. To ensure internal control and regulatory supervision are not undermined, AIs are expected not to engage in 'window dressing', i.e. lowering their quarter-end interest rate exposures temporarily in a systematic manner.
11	Do net positions used for ΔEVE calculations have to be the same as net positions used for ΔNII calculations? Are zero coupon bonds and credit card receivables in scope for the ΔNII calculations?	In general, net positions for EVE and NII calculations should be coherent. For the cases of zero coupon bonds and credit card receivables, these products are in scope for the ΔNII calculations. Including them reflects scenario-induced changes in accrued interest rate income or fee-generated income. However, notable exceptions include products with embedded optionality. An optional treatment for such products is outlined in paragraph 42 of the IRRBB Return Instructions.
12	How are spreads defined for IRRBB purposes?	Spreads are defined as the difference between the contractual interest rate and the risk-free rate. AIs cannot use other rates, such as an internal funding rate, for spread-stripping purposes.
13	How are non-performing loans	Non-performing loans (net of provisions) must be included as interest rate-sensitive assets.

	treated under the new IRRBB framework?	