Australian Banking Association

Revisions to framework on Interest Rate Risk in the Banking Book

1 March 2024

Overview

The ABA would like to thank APRA for their engagement throughout the multiple rounds of consultation on its Interest rate risk in the banking book (IRRBB) proposals. In particular, we welcome APRA's incorporation of feedback from prior representation from industry in the updated draft that has been released for consultation. Many of the issues raised in prior consultation have been responded to, and members welcome the changes that have been made.

Notwithstanding the improvements to the proposals that have been made, there are still some specific areas where additional clarification is being sought. They are outlined below.

Specific observations

APS / APG reference	Issue/questions
APG 117 – Paragraph 7	Can APRA confirm the modelling requirements of non-principal-and-interest items, given these items should not be expected to contribute to Interest rate Risk in the Banking Book?
APG 117 – Paragraph 54	Industry interpret that the maturity for RMBS refers to the expected maturity and not the legal final maturity of RMBS. Can APRA please confirm this interpretation?
APG 117 – Paragraph 57	Can APRA confirm wholly owned self-securitisation of mortgages where the intent is to create an RBA repo eligible security for liquidity purposes can be excluded from capital calculations on the basis the underlying instruments are already present in the risk, e.g. the Mortgage pool?
APG 117 – Paragraphs 58 and 59	When reading the two paragraphs together, ABA believe that the opening sentence of Paragraph 59 "Notwithstanding the above, APRA **expects** ADIs to designate derivatives as non-market related regardless of the accounting determination of hedge effectiveness", could be interpreted as "Notwithstanding the above, APRA **allows** ADIs to …". ABA seek confirmation that that interpretation is acceptable.
APG 117 – Paragraphs 58 and 60	Can APRA confirm an ADI is able to deem an offshore wholesale funding package which includes effective hedges as 'Non-Market related' where the ADI models the net AUD position, including if the ADI hedges the callable bonds cross-currency risk to the first call date. This wholesale funding would not be included in the other optionality clause (APS 117 paragraph 38).
APG 117 – Paragraph 77	Can APRA please confirm the treatment of non-maturity deposits (NMDs) at the standard inception date: **Existing Replicating:** An ADI has, for example, an existing NMD portfolio with an embedded loss of -$100 million and weighted average yield of 2 per cent. This portfolio partially meets the requirements of the new APS 117 standard, but would need to be rebalanced and/or core

volume partially divested to meet the new APS117 requirements on Oct-2025.

How should the ADI treat the embedded yield and consequently embedded loss on the rebalancing of NMD portfolio? Should the ADI:

1. Undertake the rebalancing at prevailing market rates and modifying the yields on the remaining core tranches to ensure the embedded loss of the rebalanced portfolio remains -$100 million.
2. Retaining the portfolio yield of 2 per cent on remaining replicating tranches and divest the excess core volume without embedding the notional gain/loss on divested volumes resulting in a change in the -$100 million embedded loss.
3. Other

New Replicating: the ADI has an existing NMD product which qualifies for being modelled to a 5-year term as a replicating portfolio under the proposed APS 117. At creation of the replicating portfolio, what yields should be assigned?

1. Current yields whereby the market value of the replicating portfolio at inception is $0.
2. Historic 5-year yields, simulating a portfolio which had previously existed for 5 years with a corresponding embedded gain/loss at inception.
3. Other

Removal of Replicating: If the ADI believes a product no longer qualifies as meeting the requirements for replicating due to either change in customer behaviour, product retirement or alteration in rate structure, how should the ADI treat the existing embedded gain/loss on the replicating portfolio?

1. Grandfather the portfolio and let it run-off to maturity over the original life of the replicating term.
2. Immediately remove the replicating portfolio and any embedded gain/loss
3. Other

New Product: The ADI introduces a new product with a rate structure that mimics a similar existing product that is either entirely or partially Non-interest rate sensitive. Can the ADI reply on correlation to the existing product to assesses core stability, or does the behaviour of the new product need to be independently assessed for a minimum period of time to ascertain product specific stability? If so, what period of time would be deemed sufficient?

	The optionality impact under the long repricing assumption vs additional optionality risk (APS 117 para 37 (iii)): Does APRA expect the treatment of rebalance/divesting an existing NMD replicating under the repricing assumption optionality factors to be consistent with the above for an existing replicating portfolio? For example, under an optionality stress where a decline in product volumes requires 10 per cent of the core to be divested, how should the portfolio yield and thereby embedded loss be treated? 1. If the portfolio yield on rebalancing is adjusted to ensure the embedded loss does not change, only the repricing component is impacted. 2. If the portfolio is partially divested but remaining yields left unaltered, this creates an MV gain/loss within the VaR results which effectively impacts both the repricing and yield curve (RYC) and embedded gains and loss (EGL).
APG 117 – Paragraph 78	Can APRA clarify if it is their expectation that the dimensions listed in Table 1 could be considered in any modelling of behavioural optionalities? That is, banks do not have to consider all of these dimensions? Can APRA please confirm if behavior optionality for Term Deposits is expected to be considered only within the APS 117 Paragraph 38 for the optionality add-on as opposed to Expected Shortfall calculation?
APG 117 Attachment A – Paragraphs 6 and 7	Members seek clarification as to whether a capital underlay (i.e. a 'negative' overlay) is prohibited for APS 117 internal model banks.
APS 117 Attachment A – Paragraph 2	Industry interpret this as book value is equal to economic value for all marked-to-market items. They are therefore excluded from the EGL Model. Is this interpretation aligned with APRA's intent?
APS 117 Attachment A – Paragraph 15	Can APRA confirm that the quarterly update is a minimum requirement and, if able, the ADI may also update observation period more regularly than quarterly?
APS 117 Attachment A – Paragraph 19 (a)	ABA would appreciate if APRA could include a detailed definition of "perturbed or derived", along with an example of each type of risk factor within the APG 117.
APS 117 Attachment A – Paragraphs 28 and 29	Could APRA please clarify whether earnings offset should be calculated "as at the beginning of the holding period" or "as if the earnings offset were incepted at the calculation date". • If the former, ABA's interpretation is that earnings offset should be valued as if they were priced at the respective historic roll

	dates of the swaps and that the earnings offset has a **non-zero value** at the calculation date. • If the latter, its pricing and valuation will be on the same day, which mean earnings offset is effectively excluded from EGL as it has a **zero value** at the calculation date. This seems to nullify the requirement to include earnings offset in.

Policy Lead: [redacted], Policy Director, [redacted]

About the ABA

The Australian Banking Association advocates for a strong, competitive and innovative banking industry that delivers excellent and equitable outcomes for customers. We promote and encourage policies that improve banking services for all Australians, through advocacy, research, policy expertise and thought leadership.