MORS Software

INTEREST RATE RISK MANAGEMENT
SURVEY REPORT 2019

IRR

IRRBB REGULATORY
REQUIREMENTS BECOMING CLEAR.

CHALLENGING TO BE COMPLIANT?

CHALLENGING TO BE **COMPLIANT**

MORS Software, a leading provider of integrated Treasury ALM solutions for banks, conducted its third annual Interest Rate Risk Management Survey, which was completed in February 2019.

Eighty-six (86) banks participated from thirty-six (36) countries.

The following key findings emerged and are presented in greater detail in this report.

KEY FINDINGS

- The ability to monitor and measure IRR at a higher frequency has declined during the last three years
- Especially the ability to asses sensitivity to key behavioural assumptions is surprisingly low
- Not even half of banks are compliant with the IRRBB EBA Guideline, published in July 2018
+ The ability to break down IRRBB into contractual, modelled and hedged components has improved
+ Banks have also improved in their ability to measure the interaction of IRRBB with other risks

REGULATORY INTEREST RATE RISK MANAGEMENT REQUIREMENTS ARE CHALLENGING – **THE CLOSER THE JUNE DEADLINE, THE LESS READY BANKS SEEM TO BE**

THIS IS THE THIRD ANNUAL MORS INTEREST RATE RISK (IRR) MANAGEMENT SURVEY. THE SURVEY INDICATES BANKS HAVE BECOME MORE CAREFUL IN STATING THEIR READINESS TO BE FULLY COMPLIANT WITH THE UPCOMING IRRBB REQUIREMENTS. THE EBA JULY 2018 REQUIREMENTS COME INTO FORCE IN JUNE 2019. THE SURVEYS OF THE LAST THREE YEARS SHOW SOME SURPRISING RESULTS.

MORS Software is pleased to share the results of our third Interest Rate Risk (IRR) management survey 2019. The IRR surveys from 2017, 2018 and now 2019 indicate a negative trend in banks being ready for the upcoming regulatory requirements. This year's survey was completed in February 2019. Today, less banks seem to be ready than three years ago. Has IRR monitoring and management become more challenging due to the final requirements being published as late as in July 2018 or have banks underestimated the effort needed to improve the capability to assess and measure sensitivity to key behavioural assumptions?

The development is not only negative. The ability of banks to break down IRRBB into contractual, modelled and hedged components has improved. Also, banks have improved in their ability to measure the interaction of IRRBB with other risks. These naturally indicate positive progress with those banks who need to comply.

What then could be the reason, as indicated in the survey, why the frequency capability to monitor and measure IRR has declined during the last three years? We believe this is an important issue to consider, as less than half of the banks are compliant with the IRRBB EBA Guideline, published in July 2018. There are three possible causes of such a change. Firstly, as we contend, the banks could be experiencing challenges with the regulatory requirements. Secondly, the slightly changed survey demographics could have an effect, caused by a decrease in responses from banks who have fulfilled the requirements, coupled with an increase in new respondents from geographic areas not yet concerned by the requirements. Thirdly, it is also possible that the rather late release of the final EBA July 2018 guideline and its approaching deadline has meant that respondents have compared more critically, and in more detail, the new rule book with their bank's readiness for the changes ahead.

The survey questions are meant to measure the same capabilities as last year. The questions fall into two main categories: 1) capturing the bank's technical capabilities in terms of which risks can be measured and at what frequency, and 2) understanding specific readiness to meet IRRBB requirements. From last year, we left out questions for the third category aiming to find out priorities for drivers of development. It has been clear that throughout the years the survey has shown regulatory demand as being the main driver of development in measuring and monitoring risks.

As a summary, the survey reveals that banks have room for improvement in their ability to manage, monitor and measure IRR, as well as IRRBB, on a daily frequency. Continuous development of the abilities will remain in the spotlight of our survey in the coming years.

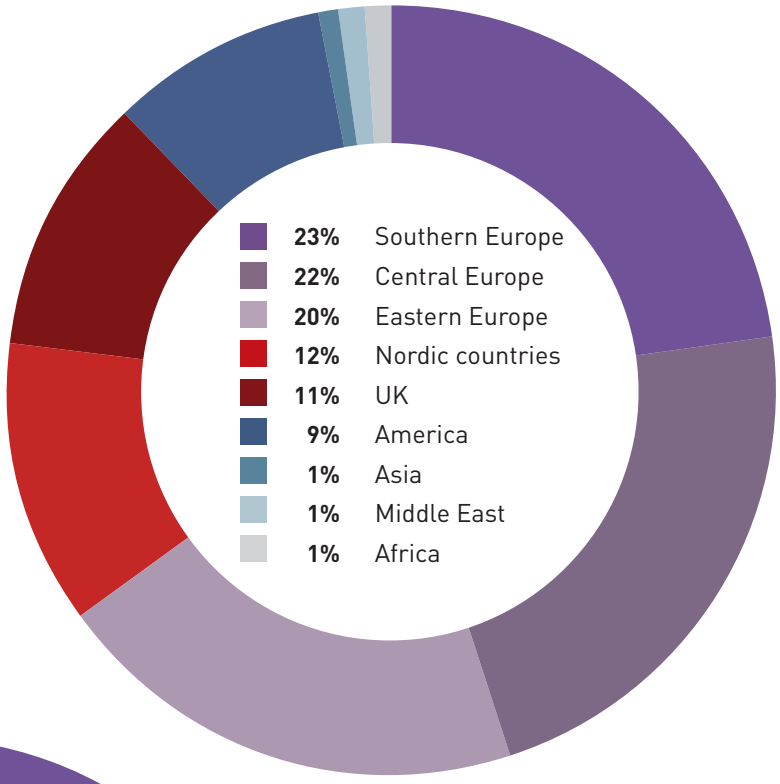
We wish to extend our sincere thanks to all the participants in this year's survey and are most grateful for the continued interest in our findings. We do hope you find the results in the booklet an interesting read, and we look forward to continuing to provide you with annual surveys on both Liquidity and Interest Rate Risk Management.

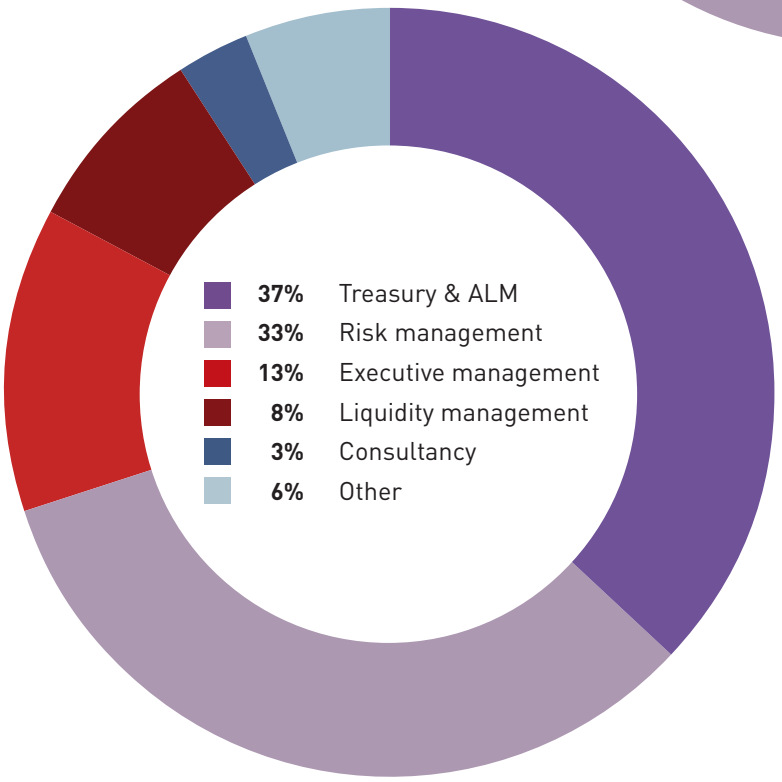
Mika Mustakallio
CEO, MORS Software

SURVEY **DEMOGRAPHICS**

86 SENIOR AND MID-LEVEL EXECUTIVES IN 36 COUNTRIES RESPONDED TO THE 2019 MORS SOFTWARE INTEREST RATE RISK SURVEY

REGIONAL PARTICIPATION





PARTICIPANT'S PROFILE

Results, Questions 1 & 2 – IRR Frequency

Still less than half of the banks are able to monitor and measure IRR exposure, limits and sub-limits, either on a daily basis or more frequently. The majority of banks are able to assess and measure the sensitivity to key behavioural assumptions for IRRBB only on a monthly basis.

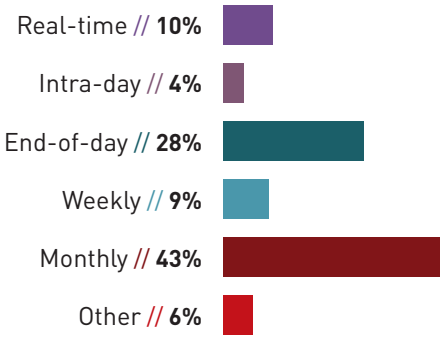
When comparing the results to last year's survey, it came as somewhat of a surprise that the outcome in both questions 1 and 2 are slightly worse. For question one, 52% of respondents rely on monthly and weekly capabilities when monitoring and measuring IRR, compared to last year results, when the percentage was 45%. Only 42% of respondents operate with daily or more frequent capabilities, when last year the percentage was 55%. 6% of respondents replied "Other", with the majority of them specifying a capability for just quarterly monitoring.

For question two, more than half of respondents (56%) state they are able to assess and measure the sensitivity to key assumptions and parameters for IRRBB only on a monthly basis, with 7% of respondents relying on a weekly frequency. In addition, 10% of respondents gave their answer as "Other" and specified their frequency as quarterly, yearly, ad hoc or even never. Together, these form a majority (73%) of responses, highlighting the challenge for banks when assessing and measuring the sensitivity to key behavioural assumptions for IRRBB.

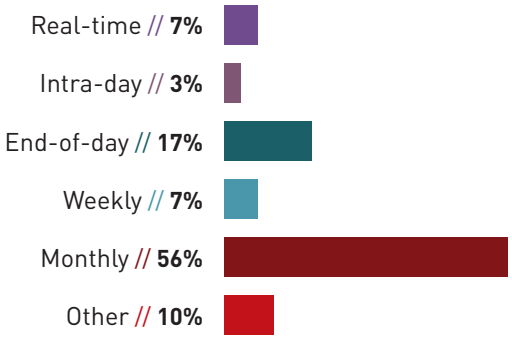
These two frequency questions indicate either a challenge for banks when developing IRR monitoring and management to work on a more frequent basis, or alternatively it is a topic where interest amongst banks has risen from that of previous years. In the latter case, the widened survey demographics reveal that more banks from around the world are interested in the topic but less of them are able to meet the frequency targets in full.

In addition to the challenges described above, the low ability to assess and measure the sensitivity to key behavioural assumptions is an alarming finding. One could expect the ability of frequent measurement to be one of the key capabilities. Without an agile capability, reacting to and stress testing potential changes becomes difficult. Agility and higher frequency to be able to adjust to changes is expected to improve materially during the coming years.

1 How frequently are you able to monitor and measure IRR (Interest Rate Risk) exposure limits and sub-limits by currency, product etc.?



2 How frequently are you able to assess and measure the sensitivity to key behavioral assumptions for IRRBB (Interest Rate Risk in the Banking Book)?



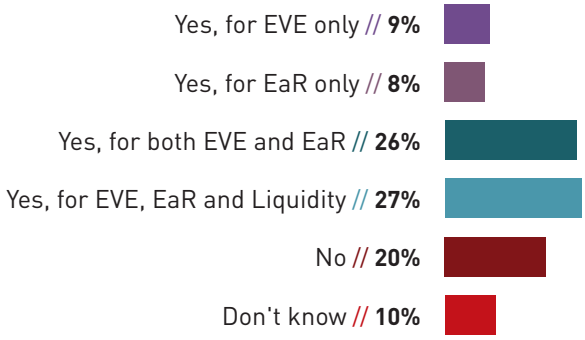
Results, Question 3 – Explaining the assumption changes

Almost one third of banks are able to explain the impact of assumption changes for EVE, EaR and Liquidity.

27% of respondents stated they are able to explain the impact of assumption changes for all three (EVE, EaR and Liquidity), 26% of respondents stated they are able to explain for both EVE and EaR. Together, these form more than half of all respondents (53%). Only 20% of respondents are not able to explain the impact of assumption changes at all. Although 10% of respondents replied "Do not know".

While this is a new question for this year's survey and there is no data to compare to from last year, this is an encouraging result and shows that most banks can explain the impact of assumption changes for at least one element.

3 Are you able to explain the impact of assumption changes, such as changes in pre-payment rates or NMD maturities?



HAVE BANKS
UNDERESTIMATED THE EFFORT NEEDED
TO COMPLY WITH REQUIREMENTS?

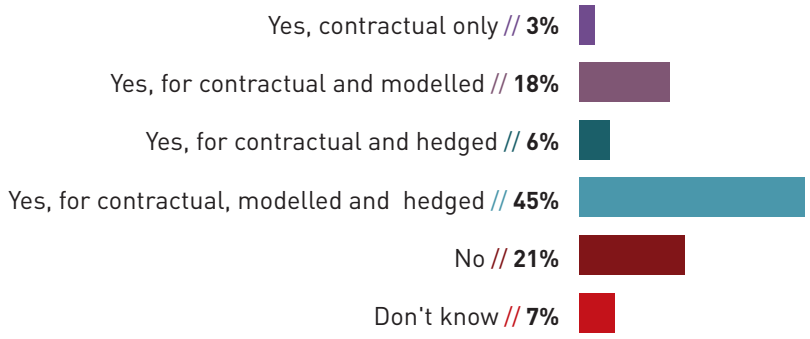
Results, Question 4 – Breaking down IRRBB

More than two-thirds of banks are able to break down IRRBB into contractual, modelled and hedged components at least within one section.

45% of respondents state they are able to break down IRRBB for contractual, modelled and hedged level, 3% for contractual level only, 18% for contractual and modelled level and 6% for contractual and hedged level. Together, these form a majority (69%) of responses, highlighting the ability to break down IRRBB at least into two components.

Comparing the results to last year's survey, it seems there has been a great improvement in this matter. Last year the survey only had "Yes", "No" and "Do not know" answer options, where 57% of the respondents stated that they are able to break down IRRBB into contractual, modelled and hedged components. Even though the question was refined this year, meaning that conclusions cannot be drawn directly, the results still show a significant improvement from last year.

4 Are you able to break down IRRBB into contractual, modelled and hedged components?



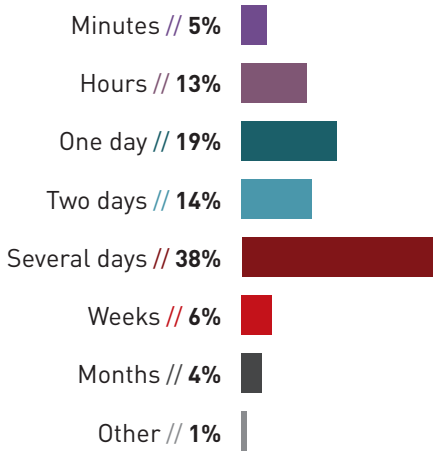
Results, Question 5 – Ad hoc readiness

The majority of banks still require two or more days to complete an ad hoc IRRBB calculation.

The results show that a majority of respondents (63%) are not able to complete an ad hoc IRRBB calculation, including data gathering, validation and calculation time, within 48 hours. Only 37 % of respondents state that they are able to complete an ad hoc IRRBB calculation within one day, or less.

This is similar to last year's survey, with no major movement in the results. This results for question 5 are in line with the results stated for questions one and two.

5 What is your lead time to complete an ad hoc IRRBB calculation, including data gathering, data validation and calculation times?



Results, Question 6 – EBA compliancy

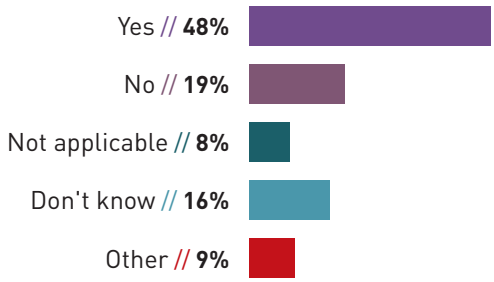
Less than half of banks are compliant with the IRRBB EBA Guideline, published in July 2018.

48% of respondents who must follow the IRRBB EBA Guideline, are compliant with the guideline. 19% stated that they are not compliant at all and 16% stated that they don't know. The "Other" category accounted for 9% of responses and most of them stated that they will start the process soon or are in the process but still require some adjustments.

This was a new question for this year's survey. EBA (European Banking Authority) published the final guidance to the Pillar 2 Framework on 19 July 2018, including IRRBB GL. The guidelines replace the existing ones and will be applicable from 30 June 2019 with transitional arrangements for specific provisions until 31 December 2019. The final revised guidelines aim at further enhancing the risk management and supervisory convergence for institutions in the supervisory review and examination process (SREP). The three reviewed guidelines focus on stress testing, particularly its use in setting Pillar 2 capital guidance (P2G), as well as interest rate risk in the banking book (IRRBB).

While it's positive that almost half of the banks are compliant, it's interesting to follow whether the rest of the banks will be compliant before July 2019 or at the latest by 31 December 2019. Naturally, bearing in mind that the EBA guideline does not concern all banks that replied to the survey, better readiness may well exist among the banks in category 1 and 2 of the EBA affected area. Several jurisdictions outside the EBA affected area have expressed their plan to launch similar regulations locally, hence, the overall number of banks being fully compliant is expected to increase in the coming years.

6 Are you compliant with the IRRBB EBA Guideline, published July 2018?



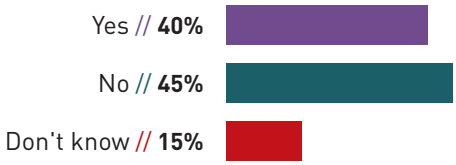
Results, Question 7 – Interaction

Banks have achieved a great improvement in their ability to measure the interaction of IRRBB with other risks.

40% of respondents stated they are able to measure the interaction of IRRBB with other risks, such as liquidity and credit risk. Still 45% of the respondents are not able to measure the interaction of IRRBB with other risks. 15% of respondents (surprisingly many) stated that they do not know whether they are able to do so.

Comparing the results to last year's survey, it seems there has been a great improvement in this matter. Last year, only 25% of the respondents affirmed their ability to measure the interaction of IRRBB with other risks.

7 Can you measure the interaction of IRRBB with other risks such as liquidity and credit risk?



40% OF THE RESPONDENTS ARE **ABLE TO MEASURE** THE INTERACTION OF IRRBB WITH OTHER RISKS

CONCLUSIONS

KEY FINDINGS

THE 3RD ANNUAL INTEREST RATE RISK MANAGEMENT SURVEY

- The ability to monitor and measure IRR at a higher frequency has declined during the last three years
- Especially the ability to asses sensitivity to key behavioural assumptions is surprisingly low
- Not even half of banks are compliant with the IRRBB EBA Guideline, published in July 2018
+ The ability to break down IRRBB into contractual, modelled and hedged components has improved
+ Banks have also improved in their ability to measure the interaction of IRRBB with other risks

This third annual MORS Interest Rate Risk (IRR) management survey indicates banks have challenges to be fully compliant with the upcoming IRRBB requirements.

Today, there seem to be fewer banks ready than there were three years ago. Has IRR monitoring and management become more challenging due to the regulations or have banks underestimated the effort needed to comply with requirements? Has the slight change in the survey demographics had an effect on the results? Such question marks arise from the survey results.

The development is not only negative. The ability of banks to break down IRRBB into contractual, modelled and hedged components has improved. Also, banks have improved in their ability to measure the interaction of IRRBB with other risks. These naturally indicate positive progress with those banks who need to comply.

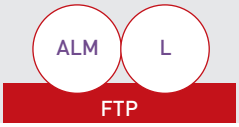
As a summary, the survey reveals that banks have room for improvement in their ability to manage, monitor and measure IRR, as well as IRRBB, on a daily frequency. Continuous development of the abilities will remain in the spotlight of our surveys.

We look forward to renewing the IRR survey in one year's time to measure progress. Prior to that, we are already excited about launching in May our next summer survey on Liquidity Risk Management.

ABOUT **MORS SOFTWARE**

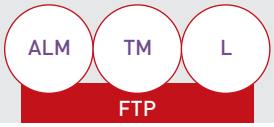
HELPING BANKS OPTIMISE THEIR BALANCE SHEET & FINANCIAL RISKS

INTEGRATED ALM



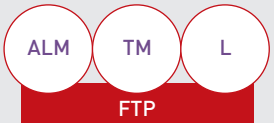
WITH MORS INTEGRATED ALM (Asset & Liability Management) APPROACH, BANKS CAN MONITOR, MANAGE AND REPORT INTEREST RATE RISK AND LIQUIDITY RISK IN ONE SYSTEM.

HOLISTIC TREASURY ALM



MORS HOLISTIC APPROACH OFFERS ALM & TREASURY MANAGEMENT FUNCTIONS IN ONE SYSTEM.

POINT SOLUTION



BANKS FULFIL SPECIFIC INTEREST RATE RISK, LIQUIDITY RISK AND TREASURY MANAGEMENT REQUIREMENTS BY USING ONE OF MORS MODULES.

ALM as a REPORTING SERVICE

MORS ALM AS A REPORTING SERVICE SUPPORTS BANKS WITH AN OUTSOURCED ALM FUNCTION.

WHY **MORS?**

IMPROVES EFFICIENCY

MORS improves Treasury ALM processes, enabling focus on risk analysis and decision making. MORS shortens lead times for report and scenario generation, providing intuitive and configurable set-ups. MORS delivers additional efficiencies covering multiple risk surfaces, such as interest rate risk, liquidity risk and counterparty risk, in one integrated system.

SAVES COSTS

MORS implementation projects are standardised, decreasing overall costs of system implementation. Once implemented, MORS gathers, reconciles and updates source data automatically, lowering system operating costs. MORS annual software license costs are fixed and include new software releases twice a year. These offer predictability and cost savings in Treasury ALM.

OPTIMISES BALANCE SHEET

MORS helps Treasury ALM practitioners maximise NII within regulatory and internal constraints. MORS calculates key ratios (such as LCR, NSFR, EaR, EVE, IRRBB) on a continuous basis, providing excellent decision-making support. In addition, MORS is a tool for internal assessment processes and ad hoc stress test requirements, further increasing the benefits of the system.

Still in doubt on how to be compliant with EBA's IRRBB guideline?
If you are in a hurry and feel the June deadline is tight, we can help you.

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MORS Software

"IRR Survey 2019" "Design. gattadesign.fr

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