Guernsey Financial Services Commission

MODULE 10

Guidance to completing the Interest Rate Risk module of BSL/2

(optional)

Interest Rate Risk on the Banking Book

Introduction

This paper outlines the Commission's reporting requirements for assessing their interest rate risk on the banking book. Interest rate risk in the banking book is a potentially significant risk which merits support from capital. The Basel Committee has noted that there is considerable heterogeneity across banks in terms of the nature of the underlying risk and the processes for monitoring and managing it. In light of this they concluded that it was appropriate to treat interest rate risk in the banking book under Pillar 2 of the Basel II framework.

This guidance includes a methodology for calculating interest rate risk on the banking book but this is not prescriptive and if banks wish to measure this risk using a different methodology they will be free to do so. The Commission will ensure that banks are holding capital commensurate with their level of interest rate risk. Where this is not seen to be the case the Commission will require banks to reduce its risk, hold a specific additional amount of capital or some combination of the two.

The Commission will be particularly attentive to the sufficiency of capital of banks where economic value declines by more than 20% of the sum of tier 1 and tier 2 capital as a result of a standardised interest rate shock (200 basis points) or its equivalent (as described in the Basel Committee document *Principles for the Management and Supervision of Interest Rate Risk.)*

Interest rate risk on the banking book: possible reporting forms

MODULE 10

Interest Rate Risk in the Banking Book

Item	Nature of Item	Risk
1.1	Interest Rate Risk - Accounting Currency	0
1.2	Interest Rate Risk - Other Currency (1)	0
1.3	Interest Rate Risk - Other Currency (2)	0
1.4	Interest Rate Risk - Other Currency (3)	0
1.5	Interest Rate Risk - All Other Currencies	0
	Total Interest Rate Risk	0
	As a percentage of Tier 1 and Tier 2 capital	

Line		Up to 1 Month	1 month to <3 months	3 months to <6 months	6 months to <12 months	1 year to <2 years	2 years to <4 years	4 years to <10 years	Over 10 years
A	**Shock move 200bp**								
A.1	**Balance Sheet Assets**								
A.1.1	Deposits with banks/building societies								
A.1.2	Debt Securities								
A.1.3	Loans and Overdrafts								
A.1.4	Mortgages								
A.1.5	All Other Balance Sheet Assets								
A.1	**Balance Sheet Assets**								
A.2	**Off Balance Sheet Assets**								
A.2.1	Interest Rate Contracts								
A.2.2	Forward Foreign Exchange Purchases								
A.2.3	Other								
A.2	**Off Balance Sheet Assets**								
A	**Assets**								
B	**Shock move 200bp**								
B.1	**Balance Sheet Liabilities**								
B.1.1	Call/Notice Accounts								
B.1.2	Fixed Term Accounts								
B.1.3	Other Accounts								
B.1.4	Bonds Issued								
B.1.5	All Other Balance Sheet Liabilities								
B.1	**Balance Sheet Liabilities**								
B.2	**Off Balance Sheet Liabilities**								
B.2.1	Interest Rate Contracts								
B.2.2	Forward Foreign Exchange Sales								
B.2.3	Other								
B.2	**Off Balance Sheet Liabilities**								
B	**Liabilities**								
C	**Shock move 200bp**								
C.1	Net Position								
C.2	Weighting								
C.3	**Weighted Position**								

D	**Loss**	

GUIDANCE TO INTEREST RATE RISK REPORTING.

General

1.1 **The purpose of this form is to suggest a methodology which might be used by banks to determine the degree of interest rate risk on the banking book they have assumed, and to calculate the amount of capital required to support the risk. The methodology is not prescriptive and banks may opt to use a different methodology as part of their assessment of interest rate risk on the banking book.**

1.2 Under this methodology banks report interest rate mismatch positions, classified in specific maturity bands according to their residual maturity.

1.3 Maturity dates and interest rate repricing dates should be determined on a worst case basis, with assets being recorded at their latest maturity and deposit liabilities at their earliest. Due regard should also taken of products that allow the customer to withdraw all, or a proportion of, their deposit prior to final maturity.

1.4 For the purpose of measuring interest rate risk, long positions in one currency cannot be offset against short positions in another currency. A separate form should be completed for each currency that represents in excess of 25% of the bank's deposit liabilities. Other currencies should be calculated individually and aggregated; the total should be reported under an "other currencies" sheet. Currencies that constitute less than 5% of total deposit liabilities may be ignored. The Commission reserves the right to request reports for individual foreign currencies at its discretion.

1.5 Where derivatives are used to hedge interest rate risk, they should be regarded as synthetic assets or liabilities for reporting purposes. Thus, in a case where the bank has hedged a one year fixed rate asset against one month floating rate, it should report the hedging transaction as a liability in the *6-12 month* band, and an asset in the *up to 1 month* band in the lines entitled "other interest rate contracts".

1.6 For the purposes of this form references to "month or months" mean calendar month or months.

Completion Notes - Assets

1.7 Interest accrued on assets as at the reporting date should be reported in the *sight < 1 month* maturity band and should be reported in the appropriate asset category.

1.8 Similarly, in the absence of a separate column, non-interest bearing assets should be reported in the *sight < 1 month* maturity band in the appropriate asset category of the form, which attracts a zero capital charge.

1.9 Report deposits with credit institutions according to the next contractual repricing date or repayment date.

1.10 Report debt securities (e.g. CDs, FRNs, and bills of exchange purchased) according to the next interest re-determination date or contractual repayment date.

1.11 Overdrafts should be reported in the *sight < one month* maturity band. Loans should be reported by the earliest date at which the bank has the ability to obtain repayment or vary the interest rate.

1.12 Variable mortgages should be reported in the *sight < 1 month* maturity band. Floating rate mortgages should be reported according to the next interest rate re-determination date. Fixed rate mortgages should be reported according to the end of the fixed period.

1.13 Report all other assets according to contractual maturity or interest rate re-determination date. The treatment of undated assets of material value should be agreed with the Commission.

1.14 Report all notional amounts receivable under interest rate-related contracts

1.15 Report forward foreign exchange purchases according to settlement date.

1.16 Report other derivative contracts amounts receivable by payment date.

Completion Notes - Liabilities

1.17 Interest accrued on liabilities as at the reporting date should be reported in the *sight < 1 month* maturity band. The interest accrued should be reported in the appropriate liability category of the form.

1.18 Similarly, non-interest bearing liabilities should be reported in the *sight < 1 month* maturity band in the appropriate liability category of the form, which attracts a zero capital charge.

1.19 Report total Call and notice accounts according to the maturity band in which the interest rate payable on the deposit can be changed or varied by the bank. Current accounts should be reported in the *sight < 1 month* band, one-month notice accounts in the *1 < 3 month* band etc. (NB: if the bank's procedure is to vary interest rates without giving notice to the customer, and the rate change takes immediate effect, the deposit should be reported as a sight liability). Where a product allows a proportion of the deposit to be withdrawn without penalty prior to the notice period, this proportion should be reported in the *sight < 1 month* maturity band. This may give rise to one deposit being split and reported over two or more maturity bands.

1.20 Report fixed term deposits according to contractual maturity.

1.21 Report all other deposit according to the next repricing date or repayment date.

1.22 Report all bonds issued according to the next repricing or repayment date.

1.23 Report all other liabilities. For capital and reserves, shareholder's equity should be entered in the *sight < 1 month* maturity band. Variable and floating rate debt should be entered by next interest rate re-determination date.

1.24 Report all other notional amounts payable under interest rate related contracts.

1.25 Report forward foreign exchange sales by settlement date.

1.26 Report all other notional amounts payable under interest rate related contracts.

1.27 Report other derivative contracts amounts receivable by payment date.

Calculations

1.28 For each band a weighted net position is calculated.

1.29 The amount at risk is the sum of the weighted positions and would be system generated for sterling and specified currencies. It is the aggregate for all other currencies that are reported.

1.30 The summary page brings forward the amount at risk from each specified currency report plus the accounting summary report and the aggregate report for all other currencies that constitute in excess of 5% of total deposit liabilities.

1.31 The total interest rate risk is the sum of all these individual risks.