

Recalibration of shocks in the Interest Rate Risk in the Banking Book standard

Description: The BCBS has released a report introducing key updates to enhance the accuracy and relevance of shocks in IRRBB, in response to evolving market conditions. These revised standards, scheduled for implementation by January 1, 2026, will allow banks ample time to align their risk management practices accordingly.

Overview of the Publication

The Basel Committee on Banking Supervision (BCBS) has released a report titled "Recalibration of Shocks for Interest Rate Risk in the Banking Book" (BCBS d578), which introduces significant updates to the framework for managing interest rate risk in the banking book (IRRBB). These adjustments are aimed at improving the accuracy and relevance of the interest rate shocks used to measure and manage risk in response to evolving market conditions, ensuring banks are better equipped to handle interest rate fluctuations. The revised standards are scheduled for implementation by January 1, 2026. This timeline provides banks with ample time to adjust their risk management practices in accordance with the new standards.

Key Updates

The report outlines 4 important changes to the IRRBB framework designed to address previous limitations and improve the effectiveness of interest rate risk management. These key updates include:

1. **Expanded Calibration Period:** The time series used for calibration has been extended from December 2015 to December 2023, enhancing the data set for more accurate shock measurement and to better reflect the latest movements in interest rates.
2. **Local Shock Factors:** The previous global shock factors are now replaced with local shock factors specific to each currency. These are calculated using the averages of absolute interest rate changes over a rolling six-month period, allowing for more precise and relevant risk assessments for different currencies.
3. **Increased Conservatism in Shock Calculation:** The percentile used to determine the shock factor has been increased from the 99th percentile to the 99.9th percentile. This change aims to maintain a higher level of conservatism, ensuring banks are better prepared for extreme interest rate movements.
4. **Finer Granularity in Rounding:** Interest rate shocks will now be rounded to the nearest 25 basis points instead of 50 basis points. This adjustment would reduce cliff effects and potential distortions across jurisdictions and would provide closer alignment with the incremental steps of changes in central banks' policy rates.

Purpose of Changes

These modifications address limitations in the previous methodology, particularly its inadequacy in capturing interest rate changes during periods when rates are near zero. By implementing these changes, the BCBS aims to enhance the accuracy and reliability of the IRRBB framework, thereby improving banks' ability to manage interest rate risk effectively.

Conclusions

The recalibration of shocks for interest rate risk in the banking book marks a significant step by the BCBS to ensure that the regulatory framework reflect current market conditions and risks. By expanding the calibration period, introducing local shock factors, increasing conservatism, and providing finer granularity in shock rounding, the BCBS aims to equip banks with better tools to manage interest rate risks effectively. These standards must be implemented by January 1st of 2026, meaning that banks whose financial year ends on 31 December would have to provide the relevant disclosure in 2026, based on information as of 31 December 2025.