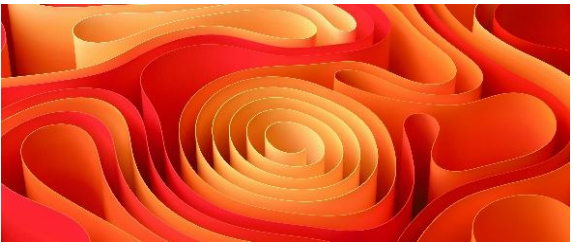
Pills

Regulatory/Supervisory Pills | N.34 March 2026



TOPICS:

IRRBB & Liquidity Risk

SOURCE:

International Swaps and Derivatives Association

ISDA: IRRBB Management in Emerging Market and Developing Economies - The Role of Derivatives in Supporting Financial Stability and Economic Development

- This paper examines **the growing importance of interest rate risk in the banking book** (IRRBB) for banks and regulators in emerging market and developing economies (EMDEs). It argues that traditional balance-sheet-based risk management approaches, while providing partial protection, are increasingly insufficient to manage interest rate exposures effectively or to support long-term economic development.
- EMDE banks typically rely on short-term or frequently repricing assets and liabilities, reflecting **limited access to long-term funding, underdeveloped capital markets** and **shallow domestic derivatives markets**. This structure reduces duration risk for banks but shifts interest rate and refinancing risk to borrowers, constraining the availability of long-term, fixed-rate credit. As a result, households, firms and governments face higher uncertainty in financing costs, which can deter investment in housing, infrastructure and productive capacity.
- The paper frames IRRBB using the international standards of the Basel Committee on Banking Supervision, highlighting **gap risk**, **basis risk** and **option risk** and the supervisory metrics of **economic value of equity** (EVE) and **net interest income** (NII). While these frameworks provide a consistent foundation, **their application** in EMDEs **is challenged** by data limitations, volatile customer behavior and weaker modeling capacity. Nonetheless, improved measurement and supervisory understanding are presented as essential prerequisites for resilience.
- A central argument is that the **development of local interest rate derivatives** (IRD) **markets** would materially enhance IRRBB management. Instruments such as swaps, basis swaps and options allow banks to hedge exposures without restructuring core balance sheets, supporting earnings stability, capital resilience and more predictable pricing of long-term credit. Case studies illustrate how derivatives can mitigate duration risk on sovereign bond holdings, support long-term infrastructure lending, manage benchmark mismatches and address embedded optionality in deposits and loans.