



December 1, 2014

Mr. Jakob Lund
Mr. Toshio Tsuiki
Co-Chairs, Task Force on Interest Rate Risk in the Banking Book (TFIR)
Basel Committee on Banking Supervision
Centralbahnplatz 2
Basel
Switzerland

Re: Industry comments on the proposed IRRBB/CSRBB QIS templates

Dear Messrs. Lund and Tsuiki:

The Institute of International Finance (IIF), the International Banking Federation (IBFed), the Global Financial Markets Association (GFMA), the International Swaps and Derivatives Association (ISDA; and jointly, the Associations), and our members would like to thank the TFIR for the opportunity to discuss the proposed templates for the interest rate risk in the banking book (IRRBB) / credit spread risk in the banking book (CSRBB) quantitative impact study (QIS) at a meeting in London on November 11, 2014. We are hopeful to continue this constructive and useful dialogue as the TFIR continues its work in developing the IRRBB/CSRBB policy frameworks.

Below, we offer our comments on the proposed templates, most of which reinforce the points we raised at the November 11 meeting.

General comments

- We understand that this may be a policy issue and that we have raised this several times before, but we would like to raise again the question of what is the IRRBB capital for. Defining this will clarify the information that should be collected, and the industry will be in a better position to suggest more realistic and helpful inputs. The industry's position on this issue is discussed in detail in the IIF/IBFed paper dated June 26, 2014.
- We agree on the need to have clear and detailed QIS guidance, including clear examples and answers to FAQs, to ensure that all issues are clarified, all elements are defined, and reporting by banks is consistent. We are pleased that the TFIR is planning to issue such guidance and FAQs.
- We request, however, that the detailed guidance be issued ahead of the official start of the QIS so banks would have time to read through, prepare, and raise questions to their national

supervisors, if necessary, before the QIS clock starts. Issuing the detailed guidance ahead of the official start of the QIS would give some additional valuable time for the banks to prepare the QIS reports. As mentioned at the meeting, unlike the regular elements of the Basel monitoring exercise (e.g. capital and leverage), the IRRBB/CSRBB with only their first comprehensive QIS early next year, could prove more challenging if done within the same timeline.

- We would like to note, however, that while detailed and very prescriptive guidance (e.g. cash flow definition, prescribing the yield curves to use, how to calculate prepayment rate, NMD categories, etc.) may result in what the TFIR may consider as comparable numbers across banks, such numbers may not be reflective of actual risks and risk management in banks. As we pointed out in our various letters to the TFIR, reliance on numbers resulting from standardization of IRRBB elements would lead to misinformed and wrongly-placed considerations and recommendations for IRRBB management and regulation.
- We also would like to highlight the importance of allowing banks to include all positions deemed important for their respective management of IRRBB. Leaving out some banking book items will undermine the analyses that can be derived from the reported data.
- It will be useful for the industry if the TFIR publishes the results and main take aways from the QIS (including those from the qualitative survey), as this will provide some rationale to the chosen policy framework. In addition, banks will be in a position to provide better inputs for the next QIS if they are aware of the analyses that have been done on the QIS data.
- It is still unclear to the industry how the QIS results would be taken into account in the consultation paper, if the latter will be issued as early as after the March 2015 meeting of the Basel Committee but the former's results will be analyzed only between May to June 2015. The expectation is that the QIS results would inform the consultation paper, so we hope the TFIR and the Basel Committee revisits the timing to make best use of information from the QIS.
- Finally, as we mentioned at the November 11 meeting in London, there are concerns about the proposed treatment of internal risk transfers from the banking book to the trading book being contemplated by the Basel Trading Book Group (TBG). As this would ultimately impact how the banking book is managed, we respectfully recommend that the TFIR plays a more active role in this discussion and establish a joint subgroup with the TBG to look at this issue. We intend to feed banking book views on this issue to the industry trading book workstream.

Specific comments

Methodology and scope (slide 4)

- As we mentioned above, having very prescriptive QIS guidance may lead to less meaningful numbers that would be misunderstood as comparable. What would result in more meaningful numbers, as far as banks' actual IRRBB exposures and management are concerned, are banks' own estimates of EVE and NII. But the resulting numbers from these estimates would be hardly comparable. This highlights the importance of the qualitative questionnaire. The qualitative

questionnaire should capture main assumptions used in own estimates to provide some basis for comparison.

- With regards to the definition of cash flows, if interest flows are to be included, we suggest that they be shown as a separate line so it will be easier for the TFIR to assess their impact. Note that if interest cash flows and principal cash flows are not reported separately, the QIS will not provide information on Net Interest Income levels and sensitivities.
- We note that the templates shared to us by the TFIR do not contain the carrying amount of the reported balance sheet item. This will not make possible the measurement of the embedded value in EVE. For instance, non- or low-interest bearing deposits embeds a positive value since they do not pay interest and are accounted for their nominal amount in the balance sheet (i.e. their 'economic value' is lower than their nominal amount, hence the positive embedded value). More generally, as most of the Banking Book items are accounted for their historical cost, they usually have an embedded value due to the difference between the historical rate they bear and the rate as of the calculation date. Without this embedded value, the only possible output from the templates will be static EVE's *sensitivities* to instantaneous shock to the yield curves, oblivious of the *level* of the EVE. This will enable the measurement only of variability risk but not of loss risk, which, as we advocated in our previous letters, is what a prudential framework on IRRBB should capture. In an EVE framework, an EVE that is sensitive to changes in rates but remains higher than the face value of equity is not a loss risk, i.e. it would lead to lower but still positive equity value for the bank.
- On the breakdown of currencies, we reiterate the importance of having a materiality threshold to avoid undue burden in completing the QIS templates. We suggest aligning the materiality threshold with the definition of "significant" currencies under the Basel LCR standard, i.e. 5% or more of the bank's banking book balance sheet. However, it should also be clarified whether only significant currencies will be reported or a catch-all "other currencies" category will also be included. Without this catch-all category, the reported banking book will not tie to the balance sheet. In addition, for this catch-all category, there is a need to clarify the relevant shocks that will apply.

Pre-payment risk/redemption risk (slide 6)

- The industry suggests extending the scope of the scenario-dependent panels beyond fixed rate mortgages and term deposits to products with optionality subject to materiality thresholds (e.g. US MBS and some non-maturing accounts). Given the range of balance sheet compositions, the TFIR should expect differences across banks with regard to what products are provided.
- The industry also suggests including interest/fee-only cashflows with optionality (e.g. mortgage servicing rights) as a separate line.
- The industry is concerned that varying cashflows by scenario could be labor intensive, and asks the TFIR to take this into account when considering the number of scenarios.

Automatic options (slide 7)

- The templates do not require the reporting of cash flows. This will not enable the adoption of a NII perspective.
- The industry suggests that embedded sold options hedged by bought options should be considered without the “exact match” requirement, which is not common industry practice (since ALM macro hedges rather than micro hedges are applied to the millions of items it manages). The prudential framework for IRRBB should not be based on the assumption of micro-hedging millions of contracts.
- Market value of bought options under different scenarios should also be captured in the template. There is no reason why there should be asymmetry between bought options considered only for their carrying amounts and sold options considered through their market value.
- Optionality is often managed at portfolio levels and in conjunction with other portfolios. Hence, for explicit options, evaluating the IRR with the option portfolio alongside of the overall IRR profile is also appropriate than focusing on particular positions in isolation.
- The QIS guidance should provide clarity as to how to exactly strip out the embedded options for QIS purposes. The industry is concerned that full revaluation for stripped out options on millions of contracts would not be feasible. The industry would prefer a sensitivities-based approach as mentioned by the TFIR at the November 11 meeting in London.
- If the TFIR goes ahead with the full revaluation approach, banks should have the flexibility to use processes used for internal management purposes so as to mitigate the additional burden this would create.

Own estimates of EVE and NII (slide 8)

- As we described in the IIF/IBFed June 26 paper, own estimates should be calculated consistent with the bank’s management framework, particularly when it comes to the horizon at which equity is invested and the duration of NMDs. Typically, EVE and NII are calculated with horizons consistent with the individual duration of the balance sheet.
- We seek clarification on whether the TFIR will provide the curves that will be used in own estimates of EVE/NII (i.e. will it be one of the “constraints”?), or will that be up to the banks? It should be noted that differences in curves used will contribute to differences in banks’ own estimates of EVE/NII and those of the TFIR’s.
- In general, for both NII and EVE modeling, we seek clarification on what types of constraints the TFIR will impose. As mentioned in the general comments, such constraints may lead to seemingly comparable results but it will not be reflective of banks’ actual risks and internal management framework. As such, the industry recommends the reporting of both unconstrained and constrained own estimates of EVE and NII, so that the TFIR will be in a

position to realize the effects of the constraints. The unconstrained estimates would give the TFIR a “management view” of how banks view and assess their IRRBB.

- We seek clarification about what “full revaluation” means in the context of NII since the concept is normally used for EVE approaches.
- We also seek clarification on what the TFIR means by “realized profits associated with banking book exposures” that it is planning to collect.

Pipelines (slide 9)

- The industry notes that there are diverse practices in managing pipelines so it will be hard to standardize in a meaningful way to capture the industry’s wide variety of practices. This should be captured instead in the qualitative survey. If pipelines should be captured in the QIS template, it should be viewed in conjunction with associated risk mitigation hedges.
- When developing the pipeline template, it would be most appropriate to show the forecasted pipeline against any pipeline hedging in order to provide the most meaningful data for analysis of the actual risks associated with the current pipeline.

Other items/products to capture in the scenario-dependent panels (slide 9)

- As previously mentioned, we suggest allowing banks the flexibility to include products such as NMDs in the scenario dependent panels if the bank feels that is a more appropriate method to capture the IRR of the product. This will enable the TFIR to measure the differences between the results from standardizing assumptions and the actual management by banks.
- In addition, there are numerous other product types that could expose banks to fixed rate exposures, such as commercial property finance, vehicle finance and other forms of installment sales. These could all expose a bank to prepayment risk.

Scenario-independent panels (slide 11)

- It is not clear what the breakdown by variable rate is for. If only the next reset date is to be reported (i.e. excluding the subsequent reset dates), only the fixed portion is reported without giving any information on the future index position.

Non-maturity deposits (slides 12 and 13)

- The industry questions the proposed breakdown of NMDs, which gives a liquidity view that is different from the interest rate risk view. This is particularly true for the transactional and non-transactional categories, which we think are not relevant for IRR management purposes. In the proposed template, we suggest removing these categories and focus on customer types (retail, wholesale) and include a breakdown between interest bearing and non-interest bearing. Ideally though we believe that rate sensitivity and stable vs. non-stable splits are more relevant to IRRBB, but note that definitions of stable for interest rate risk purposes may vary across banks.

- On the reporting of total NMDs per depositor, the industry believes it is too granular and would be potentially very onerous for large banks that have millions of depositors/accounts. It is not clear therefore whether the requested information is worth the cost of collecting it. The TFIR should reconsider asking this very granular information. At the least, it is suggested that there should be a threshold in reporting per depositor NMDs. It is also suggested that bucketing by deposit values should be different between retail and wholesale. Moreover, if one of the goals is to measure concentration, the number of depositors has to be reported and not only balances by bucket.

Basis risk (slide 14)

- The industry believes that basis risk should be measured on a dynamic balance sheet. As with slide 11, it is unclear what the TFIR will be able to do with the proposed basis risk template since only the fixed portion will be reported. It is unclear how the template would give information on basis risk, which starts after and not before the next repricing dates.
- The proposed template would require fixed rate exposures to be included as well as non rate-sensitive items such as free equity. Care would need to be taken that this also includes the NMDs under the baseline scenario. The assessment that would be derived from the proposed template could be heavily influenced by choices to include equity balances at short rates, which would not reflect the actual basis risk managed by banks.
- The industry also requests clarity as to the rationale for slotting only up to 1 year. In addition, it is not clear where administered rate products fall under in the proposed template.

Other material item/product that should be captured (slide 15)

- It is not clear if and how non-interest bearing assets and liabilities (e. g. Bank's equity, real estate, good will) should be included¹.
- The template also does not adequately cater for the reporting of interest rate risk mitigating transactions (e.g. interest rate swaps, swaptions, caps/floors). For instance, for swaps most ALM systems report this as a short and long position and in the event that the long and short position of the swap fall in the same repricing bucket it is very difficult to split it into an outflow and inflow.

CSRBB (slides 16-18)

- The industry reiterates the need to avoid double counting of elements that are already captured in the existing capital framework.
- The industry suggests that written credit derivatives should be netted by bought protection, similar to the suggestion on options for IRRBB.

¹ For detailed comments, please see the IIF/IBFed letters dated April 2, 2014 and August 4, 2014

- The industry would like to confirm that sovereign securities are excluded from the scope of the CSRBB.
- The TFIR mentioned at the November 11 meeting that it is developing a model that would capture CSRBB exposure. The industry would be willing to discuss this further with the TFIR so we can provide helpful inputs to the model.

Thank you very much again for this opportunity to comment on the draft QIS templates. Should you have questions on any of our comments above, please feel free to contact the undersigned or Jermy Prenio of the IIF (jprenio@iif.com).

Best regards,



Andres Portilla
IIF



Sally Scutt
IBFed



David Strongin
GFMA



Mark Gheerbrant
ISDA