

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

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Dear Messrs. Lund and Tsuki,

The Dutch Banking Association (Nederlandse Vereniging van Banken, NVB) appreciates the opportunity to comment on the Basel Committee on Banking Supervision's (BCBS) consultative document (CD) on Interest Rate Risk in the Banking Book (IRRBB).

In general NVB supports the views as put forward in the joint comment letter from IIF, IBFed, GFMA and ISDA. The Dutch banks also participated in the response from the European Banking Federation (EBF), and endorse its key messages too.

In line with the joint comment letter, NVB would like to emphasize that IRRBB is not suited to be measured in a standardized manner. The standardized approach as proposed by the BCBS fails to capture the actual interest rate risk positions of institutions, and will in several aspects lead to a significant increase in measured interest rate risk compared to the internal model approach, directly impacting institutions' capital positions, business models and product offerings.

In points 1, 2 and 3 below we iterate the main concerns from the joint comment letter. From point 4 and onwards we express our main concerns from a Dutch perspective.

1. A Pillar 1 approach, with its inherent methodological simplifications and standardization or constraints on internal parameters/measures, is not appropriate for IRRBB.

Given its simplified and standardized nature to accommodate global application, the current proposal will not reflect banks' actual levels of interest rate risk. Banks' approaches to IRRBB are customized to cater for the specificities of, inter alia, their different product offerings, market and regulatory environments, business models and customers' behaviour, resulting in justifiably heterogeneous assumptions, monitoring and measurement techniques and risk management.

Although we understand the BCBS wish for more standardisation and harmonisation, the negative side effects due to the local specificities as mentioned here above (no proper capitalisation against the actual risks) clearly outweigh this wish.

Therefore the NVB wishes to reiterate – as stated in the joint letter - that the reasons why the BCBS previously decided to adopt a Pillar 2 approach based on the conclusion that “management and measurement of interest rate risk was not amenable to an internationally harmonized Pillar 1 capital framework” continue to remain valid.

2. Any capital requirement for IRRBB should consider potential loss of capital, not variability risk.

Despite the market practice in the Netherlands, the NVB agrees with the joint comment letter that capital requirements for IRRBB should not be solely based on variability risk. Instead, given the dynamic and multi-period nature of IRRBB, the NVB encourages the idea that IRRBB should be part of the capital planning processes (e.g., ICAAP) under Pillar 2 which is the component of the overall framework most appropriate for capturing IRRBB. IRRBB should be evaluated in capital planning exercises (e.g., stress testing) and incorporated into the overall assessment of the adequacy of capital buffers. With this approach, while capital is not directly allocated specifically to IRRBB, the potential loss over a stated horizon is considered when defining capital buffers.

Nevertheless, variability risk can serve as base for an outlier test. However, that would work only if it does not result in an automatic capital charge but would instead be used as a trigger for further discussion between the bank and its supervisor.

If variability is the base for the capital treatment, also the qualifying capital definition should align i.e. include fair value gains that are not recognised yet in the CET1 / T1.

3. Appropriate public disclosure is important, but disclosure of standardized calculation will be misleading

While we do understand that public disclosure of appropriate information is necessary for different stakeholders to be able to assess institutions' IRRBB exposure and the risks thereof, we do not believe this can be achieved by disclosing the standardized approach calculation as this will only lead to simplistic and misleading conclusions. This is especially concerning since most stakeholders are likely to assume that the regulatory standardized measure is an accurate reflection of IRRBB, which is not in line with the institutions' actual IRRBB.

We suggest that supervisors remain to be well engaged and informed of all assumptions inherent in an institution's calculation of IRRBB and to the extent that supervisors are not comfortable with an institutions' assumptions, supervisors have the authority to engage (SREP process) and force institutions to take remediating action to enhance its processes, which would make its way into the institutions' disclosure.

In addition to the joint comment letter from IIF, IBFed, GFMA and ISDA, the NVB wishes to highlight its specific concerns regarding the proposed consultative document that could lead to a misrepresentations of the actual IRRBB risks as well as a significant capital impact for institutions in the Netherlands.

4. Non-maturing deposits (NMDs):

The proposed NMD classification and related implicit duration caps would result in a significant decrease of liability duration compared to the duration from the internal models implemented in institutions in the Netherlands. The currently applied internal models have a strong focus on the actual situation and risks perceived on the Dutch markets. The globally proposed duration caps would significantly mis-interpret the actual situation and will increase the overall interest rate gap versus the asset duration.

In addition, the standardized approach assumes a replication model for NMDs -that does not align with the replication models as implemented by most institutions in the Netherlands. Specifically, the classification in transactional and non-transactional NMDs, and the distinction of NMDs between stable and non-stable subsets are no common practice.

5. Prepayments on fixed rate loans:

In the proposed standardized approach a simple linear multiplier is applied to the prepayment rate for fixed rate loans under each interest rate shock scenario. The multipliers reflect the expectation that prepayments will be higher during periods of falling interest rates and lower during periods of rising interest rates. However, mortgage prepayments in the Netherlands are very much dependent on other factors than interest rate movements only. For example, loan-to-value is a key factor and also changes in legislation. The standardized approach fails to capture the specific prepayment dynamics of the mortgage portfolios in the Netherlands. This would significantly affect the interest rate risk profile under stressed scenarios of the mortgages books for institutions in the Netherlands.

6. Market- and balance sheet scenarios:

In general, institutions in the Netherlands have hedge programs in place to dynamically hedge interest rate risk under changing market circumstances over time. Under an instant shock, a run-off balance sheet scenario and a six-months holding period, as proposed under the standardized approach, the effects of these hedge programs are not taken into account. Therefore, overstating the risk that would materialize over time.

7. Commercial Margins Treatment:

In the proposed standardized approach cash flows are based on the external client positions, including commercial margins in excess of the internal funds transfer price. The external client positions in the banking book are however generally managed to create stable and positive margins and earnings over time, funding positions are managed against the internal funds transfer price. These margins cover, amongst others, future risk costs, operational expenses and dividend payments to shareholders.

Commercial margin cash flows are not sensitive to changes in future interest rates. NVB is therefore of the opinion that these cash flows do not represent interest rate risk. Including the positive margin cash flows in the EVE calculations would result in a significant increase in risk levels and –sensitivities from a value perspective, which does not align with the institutions internal perspective.

We are more than willing to actively participate in a second round of consultation and are at your disposal to further explain and detail our comments.