

11th of September 2015

FINAL EMF-ECBC RESPONSE TO BCBS CONSULTATION ON INTEREST RATE RISK IN THE BANKING BOOK

The European Mortgage Federation-European Covered Bond Council (EMF-ECBC)¹ is pleased to provide its comments herewith on the Basel Committee on Banking Supervision's (BCBS) Consultative Document on the risk management, capital treatment and supervision of interest rate risk in the banking book (IRRBB).

1. The EMF-ECBC agrees that banks should identify, measure and monitor IRR and hold appropriate capital against IRRBB (principle 1).
2. We endorse the reliance on economic value of equity (EVE). In this respect, products and/or business models, with matching offsetting assets and liabilities due to changes in the interest rate (zero EVE), should be exempted from the proposal².
3. Notably, cover assets and covered bonds issued due to certain statutory requirements will not be exposed to interest rate risk in an EVE-context. As an example, cover assets and covered bonds will be exposed to zero or negligible levels of changes in EVE for changes in interest rates when issued due to legislation:
 - a. Caps on payment imbalances on cover assets and covered bonds (matching principle). Payments from cover assets therefore balance payments of interest and principal on covered bonds, i.e. principal amounts of assets and liabilities are the same³.
 - b. Requirements for the issuing institution to segregate cover assets and covered bonds from other assets and liabilities, i.e. the assets and liabilities are clearly identifiable.
4. Therefore, the EMF-ECBC is convinced that cover assets and covered bonds with the above-mentioned characteristics should be exempted from the proposed requirements on supervisory reporting regarding IRRBB.
5. The EMF-ECBC strongly believes that the capital treatment for IRRBB should remain in Pillar 2 and that capital requirements should be determined considering the idiosyncratic features of a bank's risk exposure and not using highly standardised and prescriptive approaches. The ICAAP and the SREP processes under the Pillar 2 framework are best equipped for banks and regulators to appropriately assess such capital requirements for IRRBB. The Pillar 2 framework allows for the

¹ Established in 1967, the **European Mortgage Federation (EMF)** is the voice of the European mortgage industry, representing the interests of mortgage lenders and covered bond issuers at European level. The EMF provides data and information on European mortgage markets, which were worth over €6.9 trillion at the end of 2014. In 2004, the EMF founded the **European Covered Bond Council (ECBC)**, which is a platform that brings together covered bond market participants. The EMF-ECBC is registered in the EU Transparency Register under **ID Number 24967486965-09**.

² As an example, interest bearing assets and liabilities, which would be acknowledged by national supervisors as "Interdependent asset and liabilities" in the BCBS' Standards on the Net Stable Funding Ratio, would yield a zero EVE with respect to interest rate risk.

³ In addition, for some jurisdictions, the interdependency of cover assets and covered bonds is further supported by the application of a pass-through principle effectively eliminating payment imbalances on cover assets and covered bonds, i.e. the bank is acting solely as a pass-through unit.

bank's own assessment of IRRBB using internal models and a spectrum of risk metrics aligned with the banks business as usual risk management practices to be used as part of the assessment - such elements can appropriately capture and reflect the particular IRRBB exposures to which a bank is exposed.

6. The EMF-ECBC therefore strongly objects to the introduction of a Pillar 1 standardised approach, because there is evidence that a Pillar 1 tool cannot appropriately measure IRR in a risk sensitive way. This is due to differences in the management and measurement of IRR across banks and jurisdictions, as well as markets and products. The EMF-ECBC also opposes the introduction of a Pillar 1 tool as a fall-back solution for Pillar 2 (hybrid approach). Both approaches would be detrimental to fixed rate finance and could considerably dis-incentivise long term lending in the EU, which is contrary to the current European Commission's EU policy targets, i.e. growth and jobs.
7. The EMF-ECBC is opposed to the proposal that credit spread risk must be taken into account in Pillar 2. In our view, credit spread risk should be considered under the credit risk.
8. Positions with behavioural options, such as prepayments of fixed rate loans, related to non-retail customers should be subject to internal models, in the same way as such positions related to retail customers are according to the proposal. In fact, the EMF-ECBC cannot understand this proposed difference in treatment. As a principle, the EMF-ECBC believes that the application of hedging instruments should be permitted to all positions with behavioural options for risk mitigation purposes.
9. Public disclosure of the results of stress tests/shock scenarios and institution-specific parameters go beyond the confidence principle which applies to Pillar 3.
10. The requirements regarding the measurement systems and models used for the IRRBB are disproportionate as banks are not permitted to rely on a single measure of risk, but are required to use a variety of systems ranging from simple calculations based on static simulations using current holdings to more sophisticated dynamic modelling techniques that reflect potential future business activities. Instead, the EMF-ECBC believes that banks should be able to choose from a variety of systems according to the size of the institution, its business model and its risk profile. This would also be in line with the EBA requirements⁴.
11. The EMF-ECBC therefore recommends that the management of IRRBB be based on the EBA Guidelines⁵ which in any case apply from 2016 in the EU. Further requirements regarding the validation of internal bank models and their ongoing supervision/monitoring would be appropriate.

⁴ [EBA Guidelines on the management of interest rate risk arising from non-trading activities](#), 22 May 2015

⁵ As above.