THE
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ASSOCIATION
OF
BANKS
香港銀行公會

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By email: baselcommittee@bis.org

Basel Committee on banking Supervision
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

Dear Sirs,

Basel Committee on Banking Supervision - Interest Rate Risks in the Banking Book (IRRBB)

We refer to the Consultative Document on Interest Rate Risk in the Banking Book ("Consultative Document"). After consulting all members of the Hong Kong Association of Banks (HKAB), we set out below the key concerns that have been raised on the proposals.

Overall the members of HKAB have not reached a common consensus on the fundamental approach regarding the management and supervision of IRRBB as presented in the Consultative Document. However, it appears that most banks prefer capitalizing losses rather than capitalizing sensitivity as documented in the Consultative Document.

The following high level points are for your consideration whilst specific points are provided in the annex:

- The economic value of banking book can only be measured based on the present value of expected net interest income, which includes customers' margin.
- The expected future loss in the banking book should be capitalized to the same extent as the expected future loss in the trading book.
- The behaviouralisation assumptions should be firm specific as it is driven by balance sheet structure and market condition.
- IRRBB economic value modelling should exclude Tier 1 and include Tier 2, reflecting both the accounting treatment and the principal and coupon variability.

- Public disclosure of the IRRBB management framework would greatly enhance transparency, however, the quantitative risk parameters (e.g.: mentioned in Table 14 point K) will by necessity be either too high level or too granular.

We would also like to set out our comments on specific sections in the Consultative Document in the enclosed annex.

We hope that you would find our comments useful. Should you have any questions, please do not hesitate to contact Ms Emily Ngan of the Secretariat at (852) 2526 6080.

Yours faithfully,

Henry Chan
Secretary

Enc.

c.c. Ms Karen Kemp, Executive Director (Banking Policy), Hong Kong Monetary Authority

ANNEX

BCBS Consultative Document: Interest Rate Risks in the Banking Book

Sequence number	Section of the document to which comments refer:	Subsection and page number to which the comments refer:	Comments
1	Section II	1.2 Overview on the computation of minimum capital requirements for IRRBB (Stage 1), Page 11	• It is recommended that further guidance is provided on the allocation of positions into amenable, less amenable and non-amenable.
2	Section II	2.2 Interest Rate Shock Scenario Design, Page 14-15	• Please advise the definition of "a stressful rate environment" • In the interest rate shock scenario, what is the purpose of "scalar"
3	Section II	2.5 Treatment of non-maturity deposits (NMDs), Page 19-22	• Certain members do not support the 2 steps approach on the separation of NMDs. The view is that the stable portion of NMDs should be defined as how frequently these NMDs reprice which remain undrawn. • A member recommends that there should be a consistent definition on the stable portion of retail and wholesale deposits under the proposed IRRBB framework and the EBA LCR framework, for example, the stability cap of retail deposits is proposed as 70% or 80%, implying a

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			minimum runoff rate of 20 or 30% whilst a 5-10% run off rate is stated under EBA LCR." • Members raised concern with the use of the term 'Core deposit' as it tends to be associated with the liquidity framework. As such, the preference is to change the terminology and clearly mention that IRRBB is managed under a BAU environment. • The "pass through" floors are arbitrary. For example, more than 50% of the stable retail / non transaction deposit are required to be kept overnight under the proposed framework. • Further clarity is required on the rationale for the maximum tenor to be limited to 6 years.
4	Section II	2.6 Treatment of position with behavioural options other than NMDs Page 24-25	• Members expressed concern that the conditional prepayment rate is assumed to exhibit a linear relationship across different interest rate shock scenario and that it did not take into account non interest rate related factors in prepayment.
5	Section II	2.7 Automatic Interest Rate Options Page 29	• Members viewed that the cost relating to the identification and valuation of automatic interest rate options outweighs the benefit added to the outcome of the analysis.

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6	Section II	4 Earning based measures and basis risks Page 31-32	• There were diverging views about the general earnings based measure as it was viewed as being too simplistic. • Please advise the reason why the NII measure is discounted whilst basis risk effect on NII is not discounted.
7	Section II	5 Minimum capital requirements Page 34-36	• A common consensus could not be reached about this section as diverging views emerged in the industry about the appropriateness of the options presented.
8	Section III	3 Principles for Banks, Principle 1, Page 39	• The majority of credit related risks on banking book items (including default risk and credit migration components) are captured under the Basel credit risk framework and the current Basel III credit valuation adjustment (CVA) risk framework. It is recommended that the BCBS should define specifically the extent to which the credit spread element should be addressed in the IRRBB framework ensuring that these do not overlap with other Basel III regimes.