

JPMORGAN CHASE & CO.

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

Re: Consultative Document: Interest Rate Risk in the Banking Book

Dear Messrs. Lund and Tsuiki:

JPMorgan Chase & Co (JPMC) is pleased to provide comments on the Consultative Document (the Proposal) regarding revisions to Interest Rate Risk in the Banking Book (IRRBB). JPMC appreciates the TFIR's assessment of the current interest rate risk management framework, and their concern that adverse interest rate fluctuations could lead to decreased earnings, a reduction in capital position and ultimately a greater risk of insolvency for banks that are not adequately prepared. The TFIR proposes two alternatives for the treatment of IRRBB: (i) a standardized Pillar 1 capital charge, and (ii) a revised Pillar 2 approach which requires the calculation and public disclosure of the Pillar 1 standardized approach.

As addressed in greater detail below, JPMC strongly supports the application of a "pure" Pillar 2 approach to manage IRRBB that does not require the calculation or public disclosure of a Pillar 1 standardized approach. JPMC's techniques for managing interest rate risk and establishing our firm-wide "risk appetite" are based on sophisticated and dynamic methodologies that are tailored to the Firm's product offerings and customer behaviour. As such, JPMC has significant concerns with the introduction of a static, "point-in-time" based Pillar 1 capital charge, especially one that mandates which parameters all global banks should consider in their internal management of a risk that admittedly differs dramatically from one firm to another. It is JPMC's view that mandating a Pillar 1 approach that substantially mis-measures any one firm's true interest rate risk position – either as an explicit capital charge under Pillar 1 or as a required and publicly disclosed calculation under Pillar 2 – will result in adverse incentives, an unjustified increase in operational costs, and increased systemic risk in the banking system.

JPMC generally supports the views presented in the comment letters submitted by various industry trade associations¹. Below, we highlight several areas of the Proposal that are of greatest concern to JPMC. We hope the TFIR finds these comments helpful in their continued review of IRRBB.

¹ (i) The Institute of International Finance, the International Banking Federation, the Global Financial Markets Association, and the International Swaps and Derivatives Association (ii) The American Bankers Association, (iii) The Clearing House Association L.L.C..

A static Pillar 1 approach, especially one with inherent simplifications and constraints on internal parameters, will result in a fundamentally less accurate and misleading representation of JPMC's true interest rate risk position.

- Given the dynamic nature of the assumptions that impact the effective management and measurement of IRRBB, a, “point in time” Pillar 1 approach would result in a static, inaccurate, and misleading measurement of IRRBB that would likely lead to non-economic decision-making by U.S. banks.
- Standardizing which assumptions JPMC should utilize to measure IRRBB will undermine the Firm's existing IRRBB management processes that are (i) based on JPMC's product offerings and historically observed customer behaviour; and, (ii) subject to extensive validation and review both internally and through the supervisory process ².
- The Proposal's strict definition of two key measures of interest rate risk – Economic Value of Equity (EVE) and the earnings based measure (Net Interest Income sensitivity (NII)) – exemplifies the drawbacks of standardization.
 - The Pillar 1 standardized approach relies *primarily* on an EVE measure, and *secondarily* on an *overlaid* earnings-based measure.
 - JPMC views both EVE and NII as independent and important metrics to accurately assess our interest rate risk position.
 - Additionally, the Proposal's definition of the earnings-based measure assumes a static balance sheet that is based on run-off assumptions. The static balance sheet approach is inconsistent with JPMC's view that IRRBB should be measured and managed in a dynamic and forward-looking manner.
- In light of the admitted difficulties of standardizing a measurement of IRRBB that accurately represents the interest rate risk position of any one institution, the U.S. federal banking Agencies have established robust and effective interest rate risk management expectations under the existing Pillar 2 framework . The U.S. supervisory approach under Pillar 2 has been successful in large part because of the flexibility to consider factors such as the size of the bank, the nature and complexity of its activities and products, and the adequacy of its capital and earnings in relation to the bank's overall risk profile.

The inflexibility of the Proposal's standardized approach will create adverse incentives for JPMC, and increase overall systemic risk.

- The Proposal's standardized and simplistic treatment of Non-Maturity Deposits (NMDs) constrains the pass-through, stability and duration parameters JPMC could utilize to measure the interest rate risk of NMDs.
 - Constraining and standardizing key NMD metrics would undermine JPMC's robust internal IRRBB management, which is based on tailored assumptions – i.e. specific deposit portfolio characteristics or different deposit products across

² The U.S. Federal bank regulatory agencies – The Federal Reserve, Office of Comptroller of the Currency, and Federal Deposit Insurance Corp. – (guidance found [here](#)) require banking institutions to maintain “effective corporate governance, policies and procedures, risk measuring and monitoring systems, stress testing and internal controls related to their IRR exposures.”

jurisdictions – that most accurately represent the interest rate risk position of JPMC’s NMDs.

- In addition to inaccurately portraying the true interest rate risk of NMDs, the constraints of a standardized approach will likely impact the availability and pricing of certain products U.S. banks are able to provide the consumer.
 - For example, “core” NMDs enable U.S. banks to naturally mitigate the IRRBB exposure from long-term, fixed rate loans such as fixed rate mortgages. Arbitrarily limiting the maximum duration of NMDs as the Proposal requires would potentially limit the fixed rate loan offering of banks, and could significantly impact the affordability of home ownership. Furthermore, rate variability will be transferred to the general public, especially retail customers who are least equipped to manage this risk, thus creating additional systemic risk in a rising rate environment.
- Effectiveness of hedging:
 - JPMC hedges interest rate risk based on aforementioned firm-specific assumptions in an effort to manage this risk as effectively as possible.
 - The Proposal’s standardized approach does not reflect any one bank’s true risk, and will lead to different levels of capital when compared to managing this risk utilizing our dynamic and firm-specific internal processes. This will result in hedging strategies that are rooted in an inaccurate and standardized measurement of risk, leaving “real” economic risk mis-hedged.
 - Therefore, a standardized approach will increase overall systemic risk in the banking system as firms will be compelled to employ identical hedging strategies that do not account for their firm-specific product offerings or observed customer behavior just to accommodate a standardized approach to measuring and managing interest rate risk.

JPMC strongly supports the adoption of a “pure” Pillar 2 approach to measure and manage IRRBB that does not require the calculation or public disclosure of the Pillar 1 standardized approach.

- While the Proposal does outline two approaches – a Pillar 1 capital charge based on a standardized approach, and a revised Pillar 2 approach – both approaches are heavily dependent on the Proposal’s standardized approach.
- JPMC believes a “pure” Pillar 2 approach that is based on a bank’s sophisticated and tailored internal risk management processes, while also relying on the regulatory supervisory process, should be adopted.
 - U.S. federal banking Agencies have established IRRBB expectations that permit each U.S. bank, in partnership with their supervisor, to build a robust IRRBB management platform to accommodate their firm’s specific circumstances³. By not mandating one prescriptive modelling approach over another, U.S. Agencies

³ For example, the size of the bank, the nature and complexity of its activities and products, and the adequacy of its capital and earnings in relation to the bank’s overall risk profile.

enable each firm to accurately and effectively manage their true IRRBB position and, where necessary, mitigate their exposure to potential increases in interest rates.

- JPMC agrees that certain enhancements to the existing Pillar 2 approach could be beneficial. For example, in addition to the interest rate shock scenarios we conduct internally, we would support the incorporation of a common set of interest rate shock scenarios into the Pillar 2 framework that would be:
 - Calculated using banks' internal assumptions at the consolidated, firm-wide level; and,
 - Calibrated subject to national discretion to account for variations in products, customer bases and economic environments across jurisdictions.
- JPMC firmly believes that to maintain "pillar integrity", a "pure" Pillar 2 approach should not require banks to calculate or disclose a Pillar 1 standardized approach for IRRBB.
- While we strongly urge the BCBS to adopt a "pure" Pillar 2 approach, we recognize that certain jurisdictions may face country specific circumstances (i.e. less robust supervisory processes) that warrant additional regulatory action. Should the BCBS wish to provide flexibility for these jurisdictions, JPMC believes that requiring the calculation and disclosure of a Pillar 1 approach within the Pillar 2 framework should be left to national discretion.

In addition to regulatory required stress testing and capital planning which, amongst other risks, evaluates JPMC's ability to withstand adverse interest rate fluctuations, JPMC has established firm-specific policies to manage IRRBB, and allocates internal capital for IRRBB holistically in conjunction with many other managed risks.

- JPMC follows specific policies to measure and manage interest rate risk, and establish the Firm's overall appetite for interest rate risk as part of our overall portfolio of risks.
 - JPMC manages interest rate exposure related to its assets and liabilities on a consolidated, corporate-wide basis. Business units transfer their interest rate risk to JPMC Treasury through a transfer-pricing system⁴, which takes into account the elements of interest rate exposure that can be risk-managed in financial markets.
 - The JPMC CIO, Treasury and Corporate ("CTC") Risk Committee oversees structural interest rate risk policies and market risk limits. These policies and limits, subject to approval by the Risk Policy Committee of the Firm's Board of Directors, account for first and second order risks and are based on several metrics including earnings at risk, duration of equity, and changes in economic value of equity.
 - Additionally, JPMC's overall "risk appetite" limits are established (i) firm wide, (ii) by line of business, and (iii) by legal entity as applicable.

⁴ Funds transfer pricing is used to allocate interest income and expense to each business and transfer the primary interest rate risk exposures to the Treasury group within Corporate. The allocation process is unique to each business segment and considers the interest rate risk, liquidity risk and regulatory requirements of that segment as if it were operating independently, and as compared with its stand-alone peers. This process is overseen by senior management and reviewed by the Firm's Asset-Liability Committee.

- JPMC conducts several internal and regulatory required processes to ensure the accurate measurement and management of IRRBB:
 - Regulatory prescribed stress testing (i.e. The Comprehensive Capital Analysis and Review (CCAR) which is applicable to U.S. banks and the Internal Capital Adequacy Assessment Process (ICAAP) which is applicable to international banks) evaluates the adequacy of JPMC's capital buffers and directly captures the change in NII as a result of a holistic set of applicable risks, inclusive of adverse interest rate changes.
 - In addition to required CCAR stress testing, JPMC conducts internal simulations of changes in structural interest rate-sensitive revenue under a variety of interest rate scenarios. Earnings-at-risk scenarios estimate the potential change in this revenue, and the corresponding impact to the Firm's pretax core net interest income, over the following 12 months, utilizing multiple assumptions as described below. These scenarios highlight exposures to changes in interest rates, pricing sensitivities on deposits, optionality and changes in product mix. The scenarios include forecasted balance sheet changes, as well as prepayment and reinvestment behavior. Mortgage prepayment assumptions are based on current interest rates compared with underlying contractual rates, the time since origination, and other factors which are updated periodically based on historical experience.
 - JPMC conducts stress tests on the impact of the Available for Sale portfolio's unrealized gains and losses on Other Comprehensive Income, and maintains a buffer even under adverse scenarios.
- Finally, as demonstrated in the comments above, JPMC evaluates IRRBB in internal and regulatory required capital planning and stress testing exercises which take into account a broad set of risks rather than reviewing risks in a piecemeal fashion. JPMC seeks clarification that Principle 9 under the Proposal's Pillar 2 approach would not require a bank to calculate and allocate internal capital for IRRBB as a separate category, rather than as part of a broader and holistic calculation of internal capital for market risk as is currently done at JPMC.

We appreciate the opportunity to comment on this Proposal and wish to thank the TFIR for their consideration and concern for the views expressed in this letter. If you have any questions or need additional information, please feel free to contact Greg Baer at 212-270-1553 to discuss the contents of this letter at your convenience.

Respectfully yours,



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