



08/09/2015

Basel Committee
on Banking Supervision

Interest rate risk in the banking book

The Swedish Banker's Association agrees with and supports the response from the European Banking Federation. We also agree with the joint response provided by IIF, IBFed, GFMA and ISDA. Hence, the following comments are to be seen as complements to those responses.

General comments

Pillar 2 approach

The proposed Pillar 2 approach introduces a requirement of disclosure as well as the use of a standardised framework for benchmarking/fall back based on the proposed Pillar 1 approach. Disclosure of results from the standardised framework could act as an implicit floor on how much capital banks should hold against IRRBB, and will therefore in practice act as a Pillar 1 approach. We do not believe that a standardised approach would give a correct measure of banks IRRBB and that disclosure of such information would be misleading. Instead, our view is that a Pillar 2 approach, less a standardised framework for benchmarking/fall back, is the preferred approach going forward. Benchmark analysis and outlier tests can be conducted as part of such a "true" Pillar 2 approach to ensure that banks are reasonably aligned.

Proposal:

Abolish the Pillar 1 approach and rely solely on a "true" Pillar 2 approach without disclosure of results from the proposed standardised approach as discussed in the European Banking Authority's (EBA) Guidelines on the management of interest rate risk arising from non-trading activities (EBA/GL/2015/08).



Level playing field

It is important to harmonise supervisor's interpretation of IRRBB principles under a Pillar 2 approach, as this will contribute to levelling the playing field for banks across jurisdictions. A level playing field can contribute to sound competition and economic growth. Across all jurisdictions banks should be able to model behavioural balance sheet elements to the extent that this enhances the measurement of IRRBB.

Proposal:

Principles for supervisors should clearly stipulate that modelling of behavioural balance sheet elements are encouraged given that the assumptions made are rigorously tested and documented to enhance the measurement of IRRBB.

Comments to the Pillar 1 approach (section II)

Exclusion of subordinated debt

We are of the view that excluding the subordinated liabilities in the calculation of the IRRBB under Pillar 1 would artificially shorten the duration of the liabilities on the balance sheet. This since subordinated liabilities fund parts of the asset side of banks' balance sheets and thus, easily can be mapped to a contractual cash flow profile. In practice subordinated bonds are treated just as any other (fixed) rate liability, e.g. at issuance interest rate risk is usually swap hedged to the desired rollover and maturity.

Proposal:

Include AT1 and T2 instruments in the cash flow for the IRRBB calculation.

Behavioural optionality – prepayments

The BCBS paper outlines a standardised approach for prepayments on fixed rate loans, which does not consider fully the specifics of the Swedish market where much lending is done on floating rates. The method prescribed in the BCBS paper e.g. suggests modelling the margin up until contractual maturity rather than on the behavioural maturity, which will artificially prolong the asset duration of the balance sheet. It is our view that risk may be misrepresented if effects from fixed rate items (margins) for floating rate obligations, as well as from loan transformation (roll-over, re-structuring), are ignored.

Proposal:

The standardised prepayment method could, based on banks discretion, reflect and incorporate the effects of loan transformation (roll-over, restructuring) and fixed rate items under floating rate obligations should be included.



Cash flows

Applying full interest rate cash flows, i.e. the customer rate/coupon, in combination with discounting based on a risk free rate will overstate the duration and risk of the exposures. As coupons are used to compensate for the riskiness of exposures, including coupons while not reflecting this in the discount factors will result in an asymmetric treatment and overstatement of risk.

Proposal:

Exclude margins of the cash flow or include an exposure specific spread in the discount factor.

Non-maturing deposits (under the TIA approach)

By assigning a maximum duration of 3 years (and the final cash flow at 6 years) on core deposits, the duration of NMDs from a capital adequacy perspective may differ substantially from the duration derived from a more advanced empirical analysis. This risks giving rise to unwanted discrepancies between the treatment of risk from a capital and risk management perspective. Furthermore, we assess the stability caps and pass-through floors to be overly conservatively and not aligned with observed historical customer behaviour, especially for transactional retail deposits.

Proposal:

Allow for institution specific calculation of the cash flow profile of the NMDs in the IRRBB calculation and lift the maximum average duration to 5 years and longest cash flow at 10 years as partially discussed in the EBA's Guidelines on the management of interest rate risk arising from non-trading activities (EBA/GL/2015/08). Also, caps and floors should be recalibrated to lift the implied cap for transactional retail deposits to 75.

Equity duration

We are of the opinion that equity similar to NMDs is to be included in the IRRBB calculation according to the modelled/determined duration set by ALCO and aligned with the risk management of the bank.

Proposal:

The Swedish Banker's Association recommends that banks should be allowed to choose between having an explicit modelling of Equity or having an implicit target through the assets and liabilities measured by Economic Value. Regulators should set boundaries for the modelling assumptions applied by banks e.g. by setting a maximum duration of 5-10 years.



Partial offsetting across currencies

We believe that the restrictions imposed on the offsetting across different currencies (the w parameter in the BCBS document) in the calculation of minimum capital requirements under multiple currencies is arbitrary and overly restrictive.

Proposal:

Allow banks to internally calibrate the parameter for recognising partial offsetting while removing the proposed cap of 0.5.

Comments to the Pillar 2 approach (section III)

Internal capital allocated based on set limits and agreed risk appetite (principle 9)

Capital allocation should not be based on allocated limits. Instead, capital allocation should be based on risk utilisation that allow for a clear link between actual risk and capital.

Proposal:

The Swedish Banker's Association recommends that the internal capital is allocated based on risk utilisation rather than allocated limits.

SWEDISH BANKERS' ASSOCIATION



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