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September 11, 2015

Secretariat of the Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel, Switzerland

Re: Basel Committee on Banking Supervision Consultative Document – Interest Rate Risk in the Banking Book

Ladies and Gentlemen:

Wells Fargo & Company (Wells Fargo) is a diversified financial services company with over $1.7 trillion in assets providing banking, insurance, trust and investments, mortgage banking, investment banking, retail banking, brokerage services and consumer and commercial financial services. We appreciate the opportunity to comment on the Basel Committee on Banking Supervision ("BCBS") Consultative Document: *Interest rate risk in the banking book* (the "Proposal").

We support the desire to ensure banks manage interest rate risk in their banking books effectively and appropriately, and the objective to limit incentives for capital arbitrage between the trading and banking book. Unfortunately, neither of the options presented in the Proposal further these intentions. We believe these objectives are already met through the current robust Pillar 2 framework applied in many jurisdictions, including the U.S., and the BCBS need not burden these jurisdictions by imposing an inferior standardized Pillar 1 approach.

The proposed Pillar 1 approach imposes a mandatory capital charge based on a standardized calculation of interest rate risk in the banking book (IRRBB). The proposed Pillar 2 approach is simply a de facto Pillar 1 approach. The proposed Pillar 2 approach incorporates a standardized framework (i.e., a Pillar 1 approach), incremental to the currently effective supervisory review process, for benchmarking and required disclosure, with a strong presumption for an incremental IRRBB capital charge for outlier banks. In substance, by using standardized calculations the Pillar 2 approach is reduced to Pillar 1, and imposes an operational burden of multiple methods for IRRBB evaluation for banks, supervisors and users of public disclosures. We firmly believe a robust Pillar 2 approach without inclusion of the standardized calculation and disclosure framework is superior to a Pillar 1 approach for addressing IRRBB. This model of strong supervisory oversight of IRRBB and the measurement practices associated with its evaluation are already in existence for U.S. banks and our supervisors (as well as in those of many other jurisdictions). Therefore, we do not see a need for any new action contemplated by the Proposal. In our view the Proposal is unnecessary.

Concerns about the proposed Pillar 1 approach:

We do not believe a Pillar 1 approach is appropriate for banks or supervisors to address IRRBB. The proposed Pillar 1 approach will create tension between managing our IRRBB based on more sophisticated and appropriate techniques and a regulatory capital charge imposed by a standardized approach. We do not believe it is appropriate to force banks to make this trade-off and worse, it may be harmful to the banking system if banks take positions to manage a flawed measurement of IRRBB.

Imposing a minimum capital charge in the banking book to cover variability in future earnings or a questionable measure of economic value would represent a fundamental shift in the determination of banking book capital adequacy. We acknowledge that interest rate risk in the banking book includes both the variability in future earnings and the potential loss of existing capital; however, we believe capital charges are only warranted for the latter and the Proposal imposes a capital charge on the former. Because holding capital to cover potential losses is not the same as covering variability in future earnings we do not believe the proposed Pillar 1 option is consistent with the Proposal's stated objective.

The incremental charge on future earnings variability would include earnings arising from banking book assets carried at amortized cost (i.e., held-to-maturity debt securities, loans and funding liabilities). However, because it is less likely that banks will realize losses consistent with changes in fair value due to changes in interest rates for banking book positions[1], an incremental capital charge is not necessary. This treatment is distinctly different from earnings processes for the trading book, where earnings and thus capital is generally based on short-term changes in fair value. We do not believe there is justification for overriding the existing regulatory capital treatment when there are fundamental differences in the earnings process and related risk management between banking and trading book activity.

We believe the differences in the earnings process for trading and banking books justify a difference in regulatory capital treatment, and we also understand the BCBS's interest in limiting or eliminating capital arbitrage opportunities between designations. However, significant constraints are already in place regarding allocation of positions between the banking and trading books and a minimum Pillar 1 charge is not the best approach to further address concerns about appropriate designation. The Proposal only cites one jurisdiction where banks misclassified assets, which reinforces the fact that the current classification constraints are generally effective and can be enhanced rather than overridden through an IRRBB capital charge.

A more appropriate solution is to clarify the requirements for banking book and trading book classification, which the BCBS is currently addressing through its Fundamental Review of the Trading Book (FRTB)[2] project. The FRTB would strictly limit the ability of banks to voluntarily move instruments between the trading book and the banking book after initial designation and such re-designations would only be permitted in extraordinary circumstances. Moreover, the FRTB will require a surcharge if a re-designation results in a reduced capital charge. These proposed changes, along with the already implemented removal of the capital filter associated with available for sale (AFS) investment securities adequately address the arbitrage risk cited in the Proposal. As a result, we do not believe the potential for capital arbitrage is a justification for the Pillar 1 approach.

Due to differences in markets, including different interest rate environments, customer bases and product offerings of banks around the world, the sources of IRRBB for banks vary widely and any attempt to measure the risk using a standardized one-size-fits-all approach will misrepresent true economic risk.

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[1] Classification in the banking book is generally driven by management intent. In addition, sales of held-to-maturity debt securities may only occur under very limited circumstances.

[2] See Basel Committee, Fundamental Review of the Trading Book: A Revised Market Risk Framework (Oct. 31, 2014), available at http://www.bis.org/publ/bcbs265.htm, at 52; see also Basel Committee, Fundamental Review of the Trading Book: Outstanding Issues (Dec. 2014), available at http://www.bis.org/bcbs/publ/d305.htm, at 5-6.

The BCBS acknowledges these shortcomings of the standardized approach in the Proposal[3]. We disagree with the concept of "promoting greater comparability…at the expense of less precision[4]." The comparability will be artificial as will be the resulting risk measures.

Specifically, required minimum pass through rate floors, caps on core deposit levels, and maturity restrictions would materially differ from internal modeling of non-maturity deposits. Imposing a minimum pass through rate can materially alter a bank's IRRBB profile; these measures could be very different from management's expectations, historical experience, or both. Likewise, in our experience decay rates vary significantly across products and extend beyond the six year limit imposed by the proposed Pillar 1 approach. The approach also ignores the concept of mix changes within the deposit portfolio over time and across rate environments. Furthermore, deposit pricing and product offerings vary across banks and pricing decisions are not necessarily driven by interest rate movements alone, but can be impacted by strategic decisions. The proposed approach does not address these factors and such factors cannot be adequately addressed in any standardized set of assumptions. We have similar concerns with respect to other products with behavioral options such as pre-payable loans.

The Proposal's earnings-based measure is also flawed because it assumes a static run-off balance sheet rather than a dynamic balance sheet inclusive of new business assumptions. Dynamic balance sheet modeling incorporates a wide range of assumptions, such as the reinvestment of assets at maturity, product re-pricing, product mix shifts, asset and liability growth and attrition. Assumptions are based on a combination of models and reasonable management judgment. While imperfect, dynamic modeling is a more appropriate approach to measure IRRBB in earnings simulations. Our management and the U.S. banking regulators consider earnings simulations based on run-off balances alone to be of very limited value. Accordingly, the U.S. banking regulators expect banks to take into account expected changes to the balance sheet in modeling IRRBB[5].

Earnings simulation methodologies are also most useful when tailored to an individual institution. At Wells Fargo, we consider interest sensitive earnings streams outside of net interest income in our simulations, particularly in our mortgage business. A static, and exclusively net interest income based approach does not reflect the change in earnings from non-financial assets and business operations, such as mortgage originations for sale. These items, which are captured in noninterest income, may serve as natural earnings or valuation hedges to certain financial instrument portfolios.

In addition to the risks associated with inaccurate measurement of IRRBB, the proposed Pillar 1 approach would result in an unjustified operational burden. Developing and maintaining systems to calculate the IRRBB measure under the proposed Pillar 1 approach would require substantial technological and human resources. Given the shortcomings of the Pillar 1 approach previously described, we believe those resources would be better served continuing to conduct proper and effective internal risk management under appropriate supervision, as is the case for large banks in the U.S.

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[3] *See, e.g.*, Proposal at 2 ("The [P]roposal recogni[z]es that not all banking book positions are easily amenable to standardi[z]ation, given uncertainty about the timing of cash flows due to behavio[]ral aspects and embedded options (e[.]g[.,] non-maturity deposits, loan prepayment."); Proposal at 9 ("An agreed Pillar 1 approach to measuring IRRBB could . . . promote greater comparability . . . though at the expense of less precision when compared to internal model estimates.")

[4] See pg. 9 of the Consultative Document

[5] <u>See</u> Interagency Advisory on Interest Rate Management Frequently Asked Questions (Jan. 12, 2012), <u>available</u> <u>at</u> https://www.fdic.gov/news/news/financial/2012/fil12002.html, at 6. The Agencies have also encouraged banks to use earnings simulations, which, in order to be meaningful, must rely on reasonable assumptions regarding banks' balance sheets in the future. <u>See</u> <u>id.</u> at 4.

Given the flaws highlighted in the standardized calculation and disclosure proposed in both the Pillar 1 and Pillar 2 options, coupled with the strong existing Pillar 2 framework in the U.S., we do not believe that the Proposal provides incremental value to the risk management or supervisory process for institutions in the U.S. or other jurisdictions with similarly strong supervisory frameworks. As a result, we encourage the BCBS to recommend enhancements only in jurisdictions with inadequate Pillar 2 supervisory processes.

Concerns about the proposed enhanced Pillar 2 approach:

If the BCBS chooses to continue with the proposal for enhancements to Pillar 2 despite our concerns, there are certain aspects that we do not believe should be included in Pillar 2. A Pillar 2 approach should maintain clear distinction between the three pillars of the Basel framework (i.e., current state for U.S. banking industry) as it is consistent with how sophisticated financial institutions manage IRRBB. We are supportive of many of the principles included in the Proposal and believe those principles are generally consistent with our current risk management practices and supervisory process. Most critically, we believe any enhancements to the current Pillar 2 approach should pertain to interactions between banks and their supervisors and need not require additional public disclosure.

Public disclosure of information under the Pillar 2 framework would not be useful to investors and other users as we believe it could be harmful if misinterpreted. Moreover, information regarding the impact of the interest rate scenarios prescribed in the Proposal, even if measured using internal models, would not be meaningful to a user without detailed disclosure of proprietary and complex growth and pricing assumptions. Due to the volume and proprietary nature of key assumptions, we believe the results of the standardized scenarios using internal models should only be provided to supervisors with an appropriate understanding of a bank's models and assumptions to complete a thoughtful assessment and comparison, where possible, to peers.

We believe the BCBS should be particularly mindful of proprietary information when considering disclosures related to deposits. The proposed disclosures appear to require expectations of deposit business strategies (e.g., pricing) and depositor behavior. Specifically, disclosing expectations for non-contractual attrition and deposit rate response may compromise competition, which is typically based on a combination of service and rate.

Banks may alter risk management practices to manage to the proposed disclosures. Proposed disclosures based on the standardized measures of interest rate risk will likely need to be accompanied by a disclaimer that indicates the proposed disclosures are not reflective of the actual risk position of the reporting entity. At best, management will need to divert resources to reconcile the proposed disclosures to our actual view of IRRBB in order to address user questions or allay user concerns. At worst, management may make uneconomic risk management decisions in order to avoid the potential adverse consequences that may result from user misconceptions. We strongly recommend that banks retain flexibility to only disclose publicly the most relevant earnings or economic value sensitivity measures based upon its business model, risk management practices and degree of importance to investors.

Large banks in the U.S. must maintain robust asset/liability management processes (risk appetite, limits, strong measurement and governance processes), and additionally IRRBB is one of the risks captured through the Comprehensive Capital Analysis and Review (CCAR) process. CCAR ensures banks are adequately capitalized under macroeconomic and idiosyncratic stress scenarios. The regulatory guidance in the U.S. requires institutions to design bank holding company stress scenarios that particularly stress the firm's idiosyncratic risks, which include earnings and capital exposures to specific stressful interest rate scenarios as well as other economic variables and conditions. Therefore, variability in earnings and capital levels due to changes in interest rates along with other drivers are already included in our established risk tolerances and capital buffers, and thus already strongly influence our capital planning.

We do not believe formalized advance notice of changes to our IRRBB models or assumptions under Pillar 2 are necessary. While we recognize the need for the advanced notice process for changes to our advanced capital systems, which have an immediate impact on capital, we do not believe the same process should apply under a Pillar 2 framework for evaluating IRRBB. Management needs the flexibility to update model assumptions and techniques to reflect its business model, products and economic conditions on a real time basis without the burden of advance notice. In our experience, the advance notice requirement for changes to our regulatory capital advanced systems delays our implementation. We agree that significant changes to our models or key assumptions should be reviewed and substantiated in the ordinary course of the supervisory review process. Accordingly, we recommend the final rule provide for national discretion on the advance notice requirement.

Conclusion

We encourage the BCBS to consider our comments and recommendations described in this letter. If the BCBS continues with this project, sufficient national discretion should be maintained so as not to impose unnecessary and inferior processes on jurisdictions, such as the U.S., where a robust and thoughtful Pillar 2 approach already exists. If there are lagging jurisdictions, the solution is not to implement a flawed set of requirements for all to follow. Lastly, we believe that our recommendations are most appropriate to ensure banks effectively manage interest rate risks in the banking book and to eliminate capital arbitrage opportunities between the banking and trading books.

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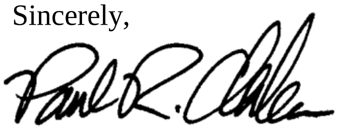
We appreciate the opportunity to comment on the issues contained the Proposal. If you have any questions, please contact me.

Sincerely,



Paul R. Ackerman
Executive Vice President and Treasurer

cc:
Norah Barger - Federal Reserve Board
Javed Ahmed - Federal Reserve Board
Donald Gabbai - Federal Reserve Board
Dianne Dobbeck - New York Federal Reserve Bank
John O'Sullivan- New York Federal Reserve Bank
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