Mr Olivier GUERSENT
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DG Financial Stability, Financial Services and Capital Markets Union
European Commission

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21 October 2016

EBF_023362

Subject: The implementation of the Basel Committee's standards on Interest Rate Risk in the Banking Book into EU legislation

Dear Mr Guersent,
Dear Olivier,

The EBF understands that European Banking Authority (EBA) plans to revise its current Guidelines, in particular the Standard Outlier Test (SOT) calculation as well as the public disclosure requirements. The impact of the proposed changes to the outlier test on European banks' business models has given rise to concern among our member banks and may need to be carefully analysed. We also believe that some adjustments to the Basel Committee' on Banking Supervision's (BCBS) standard's disclosure requirements should be considered to ensure the provision of valuable public information.

The BCBS published its Standards on Interest Rate Risk in the Banking Book (IRRBB) in April 2016. After several years of in depth discussions amongst regulators as well as with the industry, the BCBS re-affirmed its previous, long-standing position that IRRBB is more appropriately captured in a Pillar 2 framework.

The BCBS also concluded that IRRBB is heterogeneous by nature and that the complexities involved in formulating a standardised measure for IRRBB would not be sufficiently accurate and risk-sensitive to be used as a tool for setting regulatory capital requirements. The Basel Committee's conclusions are particularly pertinent for Europe given the heterogeneity of the IRRBB of European banks due to the different business models and environments they operate in.

The BCBS Standards are largely consistent with the current EBA Guidelines on the Management of Interest Rate Risk arising from non-Trading Activities published by the in May 2015. Moreover, the BCBS Standards update the principles for the management of IRRBB, notably the definition as well as the threshold applicable to the Standard Outlier Test (SOT) whose role is to identify banks' with IRRBB exposures that require supervisory engagement, and possibly corrective measures.

The BCBS Standards propose to enlarge the prescribed interest rate scenarios for which SOT should be calculated from two to six, and modifies the current 20% of Tier 1 plus Tier 2 threshold to 15% of Tier 1. This constitutes a material reduction in the SOT threshold.

As the SOT is included in the Capital Requirement Directive (CRD)[1], the transposition of the BCBS Standards in Europe would most probably require an amendment to the CRD. The requirement to amend Article 98 of the CRD to reflect the changes to the SOT provides an opportunity to clarify within the CRR/CRD, the circumstances under which Pillar II capital should be required for IRRBB to ensure its consistent application in the EU as the current wording of the rules in the CRD and CRR allow for different interpretations of the ways in which Pillar 2 capital requirements may be imposed. In the view of EBF it should be clearly stated that:

- A Pillar II IRRBB capital charge should only be required when the bank is exposed to a risk of loss as opposed to variability risk due to IRRBB. The risk that exclusively creates variability in P&L or economic value (for example IRRBB due to investments of non-interest bearing liabilities and non-interest bearing equity) should not be subject to capital charge given the absence of loss risk;

- No standardised IRRBB measure would be sufficiently accurate and risk-sensitive to be used as a tool for setting capital requirements directly or indirectly (through comparing internal calculation to a standardised measure) given the differences in products, jurisdictions and client behaviours as well as IRR management practices within Europe. It follows that no element of the standardised framework set out in section IV should be written into the CRD;

- The SOT should only be used by supervisors to identify banks whose IRRBB exposure warrants supervisory engagement and possibly corrective action. It should not play a role in the calculation of capital (a point made clearly in the EBA Guidelines).

The EBF would welcome the opportunity to contribute to the considerations of how to incorporate the BCBS Standards in the European regulation by providing in more detail our views on the implementation of the Basel IRRBB Standards in the EU. We stand ready to meet with you or your services for that purpose.

Yours sincerely,

Wim Mijs
Chief Executive

Cc: Mr Klaus Wiedner, Head of Unit, Bank Regulation & Supervision, European Commission

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[1] *The review and evaluation performed by competent authorities shall include the exposure of institutions to the interest rate risk arising from non-trading activities. Measures shall be required at least in the case of institutions whose economic value declines by more than 20 % of their own funds as a result of a sudden and unexpected change in interest rates of 200 basis points or such change as defined in the EBA guidelines.*