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Mrs Danielle Nouy
Chairman
Committee of European Banking Supervisors
(CEBS)
Floor 18, Tower 42
25 Old Broad Street

LONDON EC2N 1HQ

Brussels, 23 June 2006

BY EMAIL: CP11@c-ebs.org

Dear Madam,

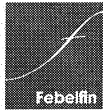
CP 11 - Supervisory Review Process of the management of interest rate risk (non-trading) and concentration risk

Febelfin, i.e. the Federation which regroups four trade associations from the Belgian financial industry¹, welcomes the opportunity to express its views on the consultation paper mentioned above. We fully support the work and role of CEBS and we hope that our comments may help CEBS in finding a balanced view on how regulation on Pillar II components should take into account the practical organisation within institutions as well as provide sufficient comfort for regulators.

Our views fully concur with those expressed by the European Banking Federation.

We have the impression that throughout the consultation document, there is a reticence as for one of the basic aspects of Pillar II, i.e. the fact that the calculation of internal capital, or the calculation of a standard interest rate shock, remains first and foremost the full responsibility of the institution itself. In our opinion, the document as it is now, is too prescriptive and should be reviewed from an angle which is more principles-based. Although we fully understand the reasons behind this reticence, we strongly plead for a more important role to be given to the dialogue between the institution and its consolidating supervisor, and this in full accordance with CP03 (Revised). We think that the supervision of Pillar II-components may require a new approach for some of the regulators (i.e. less regulation, more dialogue) when looking at institutions. However, in our opinion, this is the only way forward. Otherwise, we fear that a

¹ The following trade associations are part of Febelfin: the Belgian Bankers' and Stockbroking Firms' Association (ABB/BVB); the Professional Union of Credit Providers (UPC/BVK); the Belgian Association of Asset Managers (BEAMA); the Belgian Leasing Association (BLA).



regulation as laid down in this CP and which is too detailed, will make the rules on regular own funds largely redundant.

In our view, the CP should mirror the practices within institutions as for measuring internal capital or examining the impact of an interest rate shock. So, the CP should explicitly recognise and facilitate the calculation of internal capital or the examination of an interest rate shock on the top consolidated level. For that purpose, the CP should provide, among other things, the recognition by the home supervisor of local parameters for submarkets and the recognition of compensation effects between legal entities belonging to a single group.

Although we fully appreciate and support the efforts CEBS has been making up to now for the convergence of prudential measures, we think that the wording in the CP '*supervisors will seek to coordinate their approaches on the standard shocks*' (IRRBB 5) is not binding enough. We strongly recommend a higher degree of coordination between regulators for defining a standard interest rate shock, so as to prevent institutions from being obliged to follow different exercises.

As for concentration risk, in our opinion it is still too early to lay down detailed rules for the way in which an institution should manage that risk, since many questions are still left unanswered. We also wonder if it is appropriate to measure concentration risk along the same principles as those prevailing for credit risk. Hence, we think that it is appropriate for regulators to make an inventory of the methods used within banks for concentration risk management, before developing and applying the guidance in this CP.

If CEBS decides to pursue the development of this CP along the lines described in this document, we would like to point out that it will take at least two years before the institutions will be ready to comply with these rules and consequently, we would appreciate a postponement of the system until 1/1/2009.

Our detailed comments can be found in the annex to this letter. Please do not hesitate to contact our services and our working group should you require any further information.

Yours sincerely,

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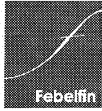
Michel Vermaerke
Chief Executive Officer

A handwritten signature in black ink, featuring a large, prominent loop at the top and several smaller loops below it.

Daniel Mareels
Head of the Taxation, Accounting Standards
and Prudential Regulations Department

Enc.

cc: Mr. E. Wymeersch, Chairman of the Banking, Finance and Insurance Commission



Supervisory Review Process of the management of interest rate risk (non-trading) and concentration risk (CP11): detailed remarks of Febelfin

1. General comments

- CP11 does not fully reflect the fact that banks, when they measure internal capital or examine the impact of an interest rate shock, do this on the top consolidated level, with allocation of the capital required to the different legal entities and taking into account local parameters.
- The level of detail for measuring internal capital mentioned in this consultation paper does not take into account the fact that the calculation in the first place is the full responsibility of the group itself, nor the existence of a dialogue with the regulators when this calculation is evaluated. In our opinion, this approach also makes the bigger part of the regulation on regular own funds redundant.
- Also, we certainly think that regulators should make a bigger effort to work out a common approach when they try to assess the impact of a standard shock.
- As for the concentration risk, we think that it is still too early to lay down detailed rules such as those mentioned in this CP about how an institution should manage this. As the concentration risk is implicitly taken into account when measuring internal capital on the top consolidated level, there is no need for a capital supplement under Pillar II.

2. Interest rate risk in the banking book (IRRBB): comments on the guidance

IRRBB 1: Institutions are required to show supervisors that their internal capital is commensurate with the level of the interest rate risk in the banking book. In that respect, institutions should be able to calculate the potential changes in their internal value resulting from changes in the level of interest rates and the overall interest rate risk in the banking book.

We are of the opinion that the calculation of the internal capital required is an individual exercise depending on different parameters which reflect the characteristics of each individual group. More particularly, we would like to draw the attention on the fact that the calculation of internal capital is done at the top consolidated level. During this exercise, compensation effects are taken into account, whereby risks of a certain legal entity may be offset by positions of another legal entity within the same group. In the end, the necessary capital per legal entity is defined and allocated, but this is done on the basis of the central

calculation at the top consolidated level. For this reason, we cannot support the detailed requirements mentioned in the two bullet points under this principle.

As such, this calculation is the full responsibility of the group itself, although we recognise the a posteriori evaluation of this exercise through the SRP (via a dialogue between the group and the consolidating regulator).

Furthermore, we notice that the entire CRD and the many detailed CEBS-papers already provide a detailed regulation for the calculation of the regular own funds. We fear that the current approach in the regulation concerning the calculation of internal capital may lead to double work which makes the rules on regular own funds redundant.

Consequently, we doubt whether a detailed regulation of the calculation of internal capital is the right way forward. Regulation cannot cover all individual parameters which have to be taken into account for this calculation, for otherwise it would become too prescriptive or too detailed. So, we would appreciate if the ICAAP- process could rely on a principles-based regulation only (as formulated in the CRD) whereby the full dialogue between the group and the consolidating regulator under the SRP-process allows the regulator to have a full insight into the calculations.

IRRBB 2: Institutions must be able to compute and report to their supervisory authority the change in their internal value as a result of applying a standard shock prescribed by the authority.

No remarks.

IRRBB 3: Besides the standard shock, larger and/or more complex institutions should measure their exposure, if material, and sensitivity, to changes in the shape of the yield curve, changes between different market rates (ie basis risk) and changes to assumptions, for example those about customer behaviour.

In general, we are in favour of this principle but we would like to draw the attention to the following :

- Institutions should be allowed to use their own estimates when calculating their sensitivity to changes in the yield curve or changes between different market rates.
- Institutions should be allowed to use their own estimates of customer behaviour and should be free to choose whether they will or will not do this by following standardised approaches.
- Every market segment has its own characteristics. Currently, banks are facing the fact that estimates based upon local characteristics are not recognised by the home regulator. The BBA is known to be in favour of a lead supervisor model in which a group is put under the supervision of a college of supervisors headed by the consolidating home supervisor. This model does not prevent however that groups, when they calculate internal capital or examine the impact of a standard interest

shock, use local parameters for the different submarkets in which they are active. We certainly think that supervisors – in the short term – should enhance their cooperation in order to leave groups the possibility of using local parameters for submarkets.

IRRBB 4: Institutions should have a well reasoned, robust and documented policy to address all issues that are important to their individual circumstances.

Although we agree that the technical issues listed under this point are based on common sense, we nevertheless would like to draw the attention on the fact that calculating the impact of an interest rate shock is an evolutionary matter. We fear that the list of technical issues may become a ‘tick box’. For this reason, we suggest to replace the words ‘this includes’ by ‘this could include’.

IRRBB 5: Supervisory authorities will set a comparable standard shock as referred to in the CRD and applicable to the non-trading book of all their relevant institutions. Supervisors may decide to set different standard shocks for different currencies. Guidelines are proposed.

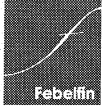
As has already been stated above, the calculation of internal capital as well as the follow-up of a standard shock are carried out on the top consolidated level. This has two implications.

First, the group takes the individual characteristics and exposures as a basis for taking its decision about the best methodology for calculating the impact of a standard shock. Because these calculations are strongly influenced by individual parameters on the one hand and because they are subject to changes on the other hand, we consider a regulatory guidance which is too detailed, to be inappropriate. So, we propose to delete the five bullet points mentioned under this principle.

Secondly, there is a need for a common approach by all regulators of a group when it comes to defining the different characteristics of the standard shock(s). Moreover, there is a need for a common approach by all regulators in this field in order to avoid unlevel playing fields. Ideally, a common approach should be defined by the Basle Committee, but, in our opinion, the second best solution would be that CEBS lays down a truly common approach in this field in order to avoid unlevel playing fields.

Within this context, we think that the wording in the last bullet point which states that ‘*supervisors will seek to coordinate their approaches on the standard shocks*’ to be too noncommittal. We strongly recommend a higher degree of coordination between (European) supervisors in this field.

IRRBB 6: The supervisory review should encompass both the qualitative and organisational aspects of interest rate risk management, an evaluation of the institution’s quantification of interest rate risk and an assessment of the adequacy of the relationship between interest rate risk and internal capital.



No remarks.

IRRBB 7: The scope of application of the supervisors' assessment of interest rate risk is that used for the Supervisory Review Process (SRP).

We support this principle, which reflects - in a more principle-based way (as compared to IRRBB 1) - the fact that the calculation of internal capital is done at the top consolidated level within a group, with allocation of capital to the different legal entities.

IRRBB 8: Supervisors will need to know and understand the internal method for calculating the internal value, and if requested the amount of earnings, exposed to interest rate risk in the banking book, including underlying assumptions.

No remarks.

IRRBB 9: Prompt prudential measures, including both qualitative and quantitative elements tailored to an institution's specific circumstances, may be required from either the overall supervisory assessment or in response to an institution reporting that its internal value may decline by more than 20% of own funds as a result of applying the supervisory standard shock.

We fully understand the reasoning behind this principle, we would like to point out that a well managed institution will take corrective measures on its own in the first place. Regulators should act only in those cases when an institution fails to do so, and when the dialogue under the SREP-process also fails.

Concentration risk: comments on the guidance

Concentration 1: All institutions should have clear policies and procedures approved by the management body in relation to exposure to concentration risk.

Concentration 2: Institutions should have appropriate internal systems or methods to identify and measure concentration risk which are suitable to the nature, scale and complexity of their business.

We think that in this particular field it is still too early to lay down detailed rules about how an institution should manage concentration risk, for many questions are still left unanswered. So, we think it is appropriate for regulators to do a stock taking exercise of the methods used within banks to manage concentration risk before developing and applying the guidance in this CP.

First of all, whenever policies on concentration risk are being determined, this is done at the top consolidated level and not on the level of legal entities, for that would be meaningless (legal entities such as some kinds of SPV for example may have a high concentration risk, but on a group level this kind of 'concentration' is meaningless).

Secondly, some banks are focussed on a specific internal sector or type of activities. In our opinion, guidance on concentration must not prevent nor hinder this kind of specialist

activities, because an institution may also be fully diversified within an internal sector or activity.

Thirdly, we doubt whether it is appropriate to measure concentration risk along the same principles as those for credit risk and wonder if it is not too early to define a detailed framework for this. More specifically:

- The very existence of any concentration risk will depend on the definition of the reference pool such as an 'internal sector' or a 'geographic region'. How should these reference pools be defined taking into account the fact that regulation must not become overprescriptive in this field as well as the need for a level playing field between banks when prudential capital is required to cover concentration risk?
- The complexity of matching the softening impact of CRM with exposures to concentration risk is enormous. IT-systems are not yet capable of connecting both these domains and we think it is still too early for achieving this since the framework for doing so, is not yet up to the point.

Concentration 3: Institutions should apply appropriate limit structures for concentration risk in relation to their overall risk appetite and/or profile.

Concentration 4: Institutions should have adequate arrangements in place for actively monitoring, managing and mitigating concentration risk against agreed policies and limits.

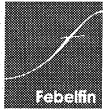
In the light of our previous comments, we think the guidance written here is too theoretical and lacks proportionality. Anyhow, we cannot agree with the proposal that new business acquisitions may be adjusted in order to cope with undue concentrations.

We truly believe that the framework needed for concentration risk is not yet up to the point, because concentration may appear in many forms and may differ depending on the definition of the reference pool and other features.

The following examples may illustrate this:

- A bancassurance group could take into account life insurance policies in order to reduce exposures for credit risk. We do not support an approach according to which the mitigation for credit risk would be (partly) reversed through a capital supplement under Pillar II when it is provided by the insurance entity of the group.
- Imagine a regional mortgage bank with a client mortgage portfolio being situated along the banks of a major river. Does the risk of this river flooding over imply a concentration risk for this bank?

Concentration 5: Institutions should assess the amount of internal capital which they consider to be adequate to hold against the level of concentration risk in their portfolio.



In measuring the internal capital, the concentration risk is implicitly taken into account, but is not accounted for separately. We think there is no need for establishing any additional capital under Pillar II to cover this risk (or to distinguish this component in the reporting).

We repeat that internal capital is measured at the top consolidated level taking into account the compensation effects between the different legal entities of a group.

Concentration 6: Supervisors will collect sufficient information from institutions on which to base their assessment.

Concentration 7: The scope of application of the supervisors' assessment of concentration risk is that used for the Supervisory Review Process (SRP).

Concentration 8: Supervisors will use quantitative indicators within their Risk Assessment Systems to assess degrees of concentration risk.

Concentration 9: The supervisory review should encompass both the qualitative and organisational aspects of concentration risk management.

Concentration 10: Supervisors can draw on stress tests performed by institutions to assess the impact of specific internal scenarios on concentrated portfolios.

Concentration 11: Supervisors will pay particular attention to those institutions which are highly concentrated by customer type or specialized nature of product.

Our general opinion is that these principles are quite identical to the CP03 (revised) and hence should be integrated into the SRP in order to avoid unnecessary additional regulation.

We notice under concentration 7 the same nature of contradiction with concentration 1 as under IRRBB. Here again, we would like to point out that calculation of internal capital (taking into account concentration risk) is done at the top consolidated level within a group, with allocation of capital to the different legal entities.

Finally, we think it is important to stress the fact that the framework presented in this CP on concentration risk is not yet ready for implementation within banks. If CEBS however decides to pursue the development of this CP, we would like to point out that it will take at least two years for all institutions to comply with this rule and so, the institutions will not be able to implement this system before 1/1/2009.