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Dear Mr. Ho,

Re: Response to Consultation paper (CP 17.04) on the Interest Rate Risk in the Banking Book (IRRBB)

The Asia Securities Industry & Financial Markets Association (ASIFMA)[1] and its members appreciate the opportunity to comment on the HKMA's consultation paper on implementing the Basel Committee on Banking Supervision's (BCBS) standard for Interest Rate Risk in the Banking Book (IRRBB).

ASIFMA and its members, through the Global Financial Markets Association (GFMA), have already voiced the industry's concerns about the BCBS's 2015 consultation on calculating interest rate risk, as well as the shortcomings of the standardised IRRBB framework proposed in that consultation.

While we appreciate the HKMA's commitment to complying with the Basel Committee's 1 January 2018 deadline for implementing IRRBB, we urge the HKMA to consider delaying implementation to align it with that of other jurisdictions. So far, only five of the 19 Basel Committee members – the European Union (EU), India, Indonesia, the United States (US) and Singapore – have published draft rules on IRRBB. Of these five Basel Committee members, only Indonesia has said it intends to meet the 1 January 2018 deadline.

Several important jurisdictions have indicated their intention to delay IRRBB implementation beyond the BCBS's deadline. Due to the lengthy time often required to navigate the EU legislative process, the EU is likely to implement the overall framework by 2020, and the disclosure requirement by 2021. US regulators have not yet announced their IRRBB timeline. In Asia, the Monetary Authority of Singapore (MAS) planned to implement IRRBB in December 2017, but recently informed affected banks that it would move that

[1] ASIFMA is an independent, regional trade association with over 80 member firms comprising a diverse range of leading financial institutions from both the buy and sell side, including banks, asset managers, law firms and market infrastructure service providers. Together, we harness the shared interests of the financial industry to promote the development of liquid, deep and broad capital markets in Asia. ASIFMA advocates stable, innovative, competitive and efficient Asian capital markets that are necessary to support the region's economic growth. We drive consensus, advocate solutions and effect change around key issues through the collective strength and clarity of one industry voice. Our many initiatives include consultations with regulators and exchanges, development of uniform industry standards, advocacy for enhanced markets through policy papers, and lowering the cost of doing business in the region. Through the GFMA alliance with SIFMA in the United States and AFME in Europe, ASIFMA also provides insights on global best practices and standards to benefit the region.

deadline to December 2018 for implementation by 1 January 2019. India has also issued draft guidelines that delay IRRBB implementation until 1 April 2019.[2]

Implementation of the IRRBB ahead of other jurisdictions, especially the home jurisdictions of major banking groups operating in Hong Kong, would create operational difficulties for those institutions. From a systems perspective, for example, it would be difficult and expensive for a banking group to implement IRRBB in one location in Asia rather than on a global basis. Additionally, the consultation calls for six standardised interest rate shock scenarios, which would pose another significant hurdle by requiring between 12 and 18 months to build and test.

We are deeply concerned that early implementation of IRRBB in Hong Kong may result in conflicting IRRRB requirements as requirements elsewhere may yet evolve and some regulators may take steps to ensure that new regulations do not harm their markets. A recent US Treasury report[3], while not specifically addressing IRRBB, highlighted the US regulators' concerns with a number of other upcoming Basel Committee proposals.

Given that it remains unclear how the US or EU will implement IRRBB, we strongly urge the HKMA to delay implementation to allow for these jurisdictions' IRRBB proposals to be finalised before potentially introducing misaligned or overly stringent standards in Hong Kong.

In addition to the HKMA's timeline, we are concerned about the scope of application of IRRBB as proposed in Section II, Subsection 3 of the consultation paper. We provide further details on those concerns in the first part of this response.

In the second part of this response, we outline the broader issues stemming from Section II, Subsection 4 of the consultation paper, which limits authorised institutions (AIs) by requiring them to measure their IRRBB exposures based on the standardised economic value of equity (EVE) risk measure.

We provide specific feedback on Section III, Subsection 8 of the consultation regarding interest rate shock scenarios and suggest areas that could benefit from clarification in the accompanying amendments to supervisory policy manual IR-1 and to the return of "MA(BS)12 – Interest Rate Risk Exposures."

Scope

Hong Kong is a host jurisdiction to a large number of global systemically important banks; some of these institutions are also systemically important to Hong Kong. However, the proposed application of IRRBB to all AIs is of great concern to the industry.

We appreciate that the HKMA has exempted AIs incorporated overseas from some requirements, including the outlier test. However, we urge the HKMA to reconsider its requirement that all AIs, both locally and overseas incorporated, measure and report their IRRBB exposures.

We question whether this disclosure by overseas-incorporated AIs will benefit financial stability or be meaningful to investors. It would be difficult for investors to use local IRRBB exposures to gauge risk as the

[2] Reserve Bank of India (RBI), "Draft Guidelines for Interest Rate Risk in the Banking Book," 2 February 2017, https://www.rbi.org.in/scripts/bs_viewcontent.aspx?Id=3308

approach to managing the balance sheet could be different between different AIs – and thereby branch to branch comparisons could be taken out of perspective. Given that the HKMA has generally exempted or implemented simpler reporting requirements for Category 2 AIs, we suggest that Category 2 AIs either be exempted from reporting their local IRRBB or that they be subjected to a simplified IRRBB framework. We do not believe that applying to Category 2 AIs a standardised calculation of interest rate risk in Hong Kong alone is an appropriate way to gauge these AIs' interest rate risk, and may result in misleading reports of interest rate risk. Further, it is operationally challenging to implement a local solution in addition to a global solution that has not yet been implemented.

In addition, we suggest that the HKMA allow Category 1 AIs not based in Hong Kong to report their IRRBB using their parents' models. Allowing these category 1 AIs to rely on parent models would reduce any potential inconsistencies in reporting between an AI's home jurisdiction and Hong Kong.

Standardised approach

The HKMA proposes allowing AIs to use only the standardised approach when calculating IRRBB exposures, which the BCBS's final guidance on IRRBB permits but does not enforce. We strongly urge the HKMA to consider allowing greater flexibility in the use of internal models to assess interest rate risk.

Regulators in other jurisdictions recognise that interest rate risk varies significantly across AIs, and have adopted more flexible frameworks. For example, a 2010 US interagency memo titled "Advisory on Interest Rate Risk Management" emphasises that regulators "expect all institutions to manage their IRR [interest-rate risk] exposures using processes and systems commensurate with their earnings and capital levels, complexity, business model, risk profile, and scope of operations."[4]

The Monetary Authority of Singapore (MAS) in its January 2017 consultation on local implementation of IRRBB proposes allowing reporting banks to use either their internal measurement systems or the standardised approach to calculate IRRBB.[5] The MAS proposes requiring banks to apply the standardised approach only if the MAS determines that a bank's internal measurement systems are deficient in measuring IRRBB.[6]

We are concerned that requiring all AIs to measure interest rate risk using the standardised approach may hinder the ability of the HKMA to conduct monetary policy. In addition, requiring a standardised measurement of interest rate risk does not reflect the diverse range of AIs that operate in Hong Kong, for example, their different product offerings, markets, regulatory environments, business models and customer behaviour. Given these differences, we are deeply concerned that requiring a standardised approach does not necessarily accommodate the diversity of products and risks inherent when calculating IRRBB exposures.

It is also unclear how AIs that use an internal ratings-based approach outside Hong Kong would convert their interest rate exposures into Hong Kong's standardised approach. As we suggested above in the discussion on the scope of the HKMA's proposal, requiring banks that use an internal measurement system

[4] Board of Governors of the US Federal Reserve and other federal regulators, "Interagency Advisory on Interest Rate Risk" (SR 10-1), 11 January 2010, https://www.federalreserve.gov/boarddocs/srletters/2010/sr1001.htm

[5] Monetary Authority of Singapore, "Proposed Amendments on the Capital Framework for Securitisation Exposures and Interest Rate in the Banking Book in MAS Notice 637" (P001-2017), January 2017, http://www.mas.gov.sg/~/media/MAS/News%20and%20Publications/Consultation%20Papers/9%20Jan%202017%20Consultation%20Paper%20on%20Proposed%20Amendments%20to%20MAS%20Notice%20637.pdf .

elsewhere to report their IRR exposures in Hong Kong using the standardised approach may create inconsistencies that mislead or confuse investors.

Requiring all banks in Hong Kong to adopt the standardised approach also incentivises herd behaviour and therefore concentrates risk. For example, if all banks in Hong Kong use a standardised approach to model their non-maturity deposits (NMDs), they will be incentivised to crowd around similar hedging durations to reduce their reported IRRBB exposure. That would create problems in markets where there is already limited liquidity in Asia, such as interest-rate swaps.

In addition, requiring banks to use the standardised approach for NMD modelling will add to banks' operational burden. The standardised approach for NMD modelling can differ substantially from banks' own internal models, which are typically based on each bank's set of products, clients and market base.

Using the standardised approach on NMDs may also create perverse outcomes that exaggerate a bank's real interest rate risks. The standardised approach may appear conservative, for example, when enforcing a minimum portion of deposits to be modelled as re-pricing overnight (e.g., the standardised approach stipulates at least 50% of wholesale client deposits). But that is only the case when interest rates are rising, as the standardised approach captures the risk of a portion of the deposits effectively re-pricing due to shifts or outflows triggered by rising rates.

If interest rates are falling, however, the standardised approach exaggerates the potential for rapid re-pricing. And if a bank re-invests those deposits to hedge that exaggerated risk, it can have the perverse effect of increasing the bank's earnings risk. This especially applies for deposits with slowly reacting rates, such as non-remunerated deposits. When market rates are falling, such deposit volumes typically remain constant.

Specific feedback

Aside from the industry's broader concerns about the proposed IRRBB standard's scope and requirement to use the standardised approach, we would also appreciate clarification on the questions below.

Section III, Subsection 8 – Interest rate shock scenarios

We note that the HKMA sets out six interest rate shock scenarios in Section III, Subsection 8 of the consultation paper, which are based on the BCBS standard. We are concerned that there is a risk that competent authorities may deviate from the BCBS standard, which would result in inconsistency in IRRBB consultations. We would appreciate clarity on that point.

With regards to the six interest rate shock scenarios for selected currencies, we note that AIs are required to contact the HKMA if the AI needs to report IRRBB on a currency not in the consultation paper. We note this may not be practical, as AIs will need time to incorporate currency interest rate shock scenarios, advised by the HKMA, into their systems. We encourage the HKMA to clearly outline the process for AIs to request interest rate shock scenarios for currencies not included in the consultation paper, as well as associated timelines. We also encourage the HKMA to broaden the scope of currency interest rate shock scenarios in the consultation paper, to mitigate the need for AIs to contact the HKMA, given the tight reporting deadlines outlined in the consultation paper.

Supervisory Policy Manual (SPM) Interest Rate - 1 (IR-1) updated – Section 7.4.4

The revised SPM includes a new section that sets out the key considerations for AIs when developing interest rate shock scenarios. We would appreciate clarification on the last bullet-point in that section, which reads: "AIs should perform qualitative and quantitative reverse stress tests to identify key vulnerabilities."

We believe that the HKMA intends to align the SPM Section 7.4.4 with the Basel Committee's final IRRBB standard, but would appreciate further clarity on this point. Specifically, it seems that the Section 7.4.4 aligns with paragraph 43 of the April 2016 IRRBB standards, which specifies that banks should identify interest rate scenarios that could severely threaten a bank's capital and earnings, and reveal vulnerabilities. It follows by emphasising that IRRBB reverse stress testing should be integrated in the existing capital reserve stress-testing exercise, and should not be conducted on a standalone basis.

Draft return of "MA(BS)12 – Interest Rate Risk Exposures"

The reporting template on page four of MA(BS)12 requires that AIs break down the impact on Economic Value of Equity (EVE) by scenario, and by all time bands on a total basis per scenario, which is consistent with the Basel standard. However, this breakdown of EVE impact by time band would impose an additional compliance burden while creating little or no operational benefit. We would appreciate reconciliation of the figures shown in the sample return form and the data given in Annex 1.

We welcome the opportunity for continued engagement with the HKMA as it considers this important regulation. If you have further questions or would otherwise like to follow up, please contact Wayne Arnold, ASIFMA's Executive Director and Head of Policy and Regulatory Affairs, at warnold@asifma.org or +852 2531 6560.

Sincerely,

Mark Austen
Chief Executive Officer
Asia Securities Industry & Financial Markets Association

Cc: Richard Chu (Head, Banking Policy Division, Banking Policy Dept.), Gillian Hui (Head, External Department), Martin Sprenger (Head, Policy Research and Development Division, Banking Policy Dept.)