

20 December 2019

Redacted

Australian Prudential Regulation Authority

Via email: Redacted

Dear Redacted

Interest rate risk in the banking book for authorised deposit-taking institutions (APS 117)

COBA welcomes the opportunity to comment on APRA's draft APS 117 Interest Rate Risk in the Banking Book.

COBA is the industry association for Australia's customer owned banking institutions (mutual banks, credit unions and building societies). Collectively, our sector has over \$127 billion in assets, around 10 per cent of the household deposits market and 4 million customers. Our sector has 69 ADIs. This represents the majority of Australian-owned ADIs.

Existing interest rate risk management practices and requirements

All COBA members are the standardised ADIs under APRA's capital framework and have not previously been subject to the APS 117 risk management requirements. However, this does not mean that this risk is not managed. Standardised ADIs are currently subject to:

- CPS 220 Risk Management,
- Reporting Standard ARS 117.0 Repricing Risk, and
- APRA's supervision regarding interest rate risk management.

If the draft standard is finalised, this will be the first time that specific APS 117 risk management requirements will be applied to all ADIs. This will create additional compliance costs.

COBA acknowledges that the proposed APS 117 risk management requirements have been made more 'proportional' given its original application to internal ratings-based (IRB) ADIs. However, the degree of this proportionality is unclear given these revisions have taken the form of a 'stripped back' version of the current APS 117.

COBA urges APRA to build a proportionate regime from first principles rather than a cut down version of the advanced ADIs regime. This could take the form of further CPS 220 Risk Management expectations on interest rate risk or a third APS 117 regime.

Clear scope for a proportional approach

APRA has the discretion to take a more proportionate approach under the Basel Committee's Interest Rate Risk in the Banking Book. This standard notes that:

"Consistent with the scope of application of the Basel II framework, the proposed framework would be applied to large internationally active banks on a consolidated basis. Supervisors have

Suite 403, Level 4, 151 Castlereagh Street,
Sydney NSW 2000

Suite 4C, 16 National Circuit,
Barton ACT 2600

national discretion to apply the IRRBB framework to other non-internationally active institutions.”¹

Exercising this national discretion aligns with the Basel Committee’s recently released statement on proportionality, which notes that:

“The Basel Committee and the Basel Consultative Group (BCG) support the use of proportionality in implementing the Basel Framework in a manner consistent with the Core Principles. The Basel Framework envisions a range of approaches, from simpler standardised approaches to advanced approaches.”²

The Basel Committee has already highlighted the potential concerns that the regulatory framework, particularly the new IRRBB standard, could ‘significantly’ increase regulatory burden.

“The post-crisis regulatory framework has arguably added complexity and has increased compliance and reporting costs. In particular, the new standards for market risk, the LCR and NSFR, **the new standard on interest rate risk in the banking book (IRRBB)**, the revised Pillar 3 templates and the enhanced Counterparty Credit Risk (CCR) approach may contribute significantly to increasing the regulatory burden for banks.” [COBA emphasis]³

However, it does note that areas that are “more principle-based by design” such as “Pillar 2 and **interest rate risk in the banking book**, offer more scope to further reduce the regulatory burden.”⁴

Focus on targets, i.e. a few ‘mid-tier’ or ‘larger standardised’ ADIs

A more ‘tiered’ approach will address the APRA-identified issues leading to APRA’s proposal to extend these risk management requirements.

The APRA Response Paper notes the rationale is that: “In recent years, some mid-tier ADIs have implemented strategies that introduce uncapitalised interest rate risk into their operations.”⁵

A similar rationale is outlined in the APRA 2018 Capital Framework Paper with APRA noting that “Additionally, APRA notes that, in recent years, a number of the larger standardised ADIs have implemented lending strategies that may introduce significant interest rate risk into their operations.”⁶

COBA acknowledges that all ADIs are subject to interest rate risk, however, for ADIs outside the above identified risk groups, this can be dealt with under the existing CPS 220 or through a simpler principles-based regime.

Imposing these risk management requirements on all ADIs as proposed in the current APS 117 will unnecessarily increase the compliance costs on smaller ADIs that do not engage in the higher risk activity.

Utilising simpler approaches and a regulator ‘opt-in’ approach to reduce compliance costs

COBA proposes that APRA undertake a ‘tiered’ approach to these requirements. We believe this can be done by modifying the APRA proposed approach by adding another ‘tier’ for ADIs that have not introduced significant interest rate risk into their activities.

¹ Basel Committee on Banking Supervision (BCBS) 2016, Standards: Interest Rate Risk in the Banking Book, page 2, available [online](#).

² BCBS 2019, Joint BCBS-BCG statement on proportionality, available [online](#)

³ FSI Insights on policy implementation No 1 Proportionality in banking regulation: a cross-country comparison, page 3, available [online](#).

⁴ Ibid, page 2.

⁵ APRA 2019, Response to Submissions: Interest rate risk in the banking book for ADIs, page 22, available [online](#).

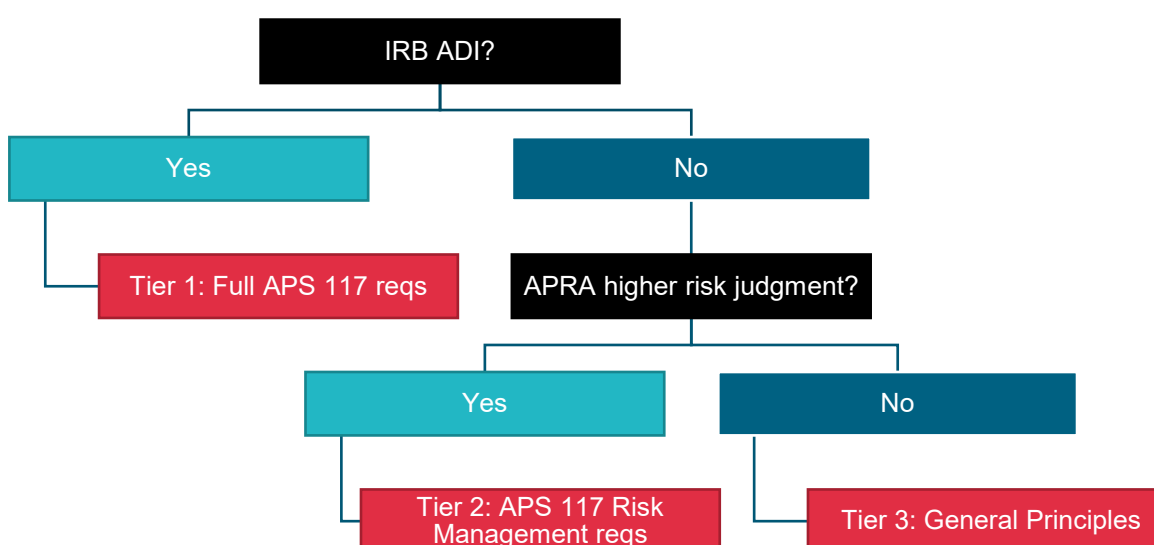
⁶ APRA 2018, Revisions to the capital framework for ADIs, page 44, available [online](#).

This 'tiering' approach means that:

- The full APS 117 compliance costs are only incurred by IRB ADIs. These IRB ADIs have 'actively' made the decision to incur these costs due to their IRB status.
- The 'mid-tier' APS 117 compliance costs are only incurred by those whose APRA judges based on objective measures to be undertaking significant higher interest rate risk activities. This would be an 'active' regulator decision.
- The 'simple tier' APS 117 requirements would be applied to the remaining ADIs, with these compliance costs being reduced through a targeted 'first principles' approach, rather than just a cut-down version of the existing APS 117.

Under such an approach, the higher tiers (and compliance costs) would all be done via an 'active' decision whether it is by the ADI or a regulator.

Chart 1: Outline of a 'tiered' IRRBB approach



The first tier is the approach applied to IRB ADIs, which includes the full risk management requirements and the IRRBB capital charges. The boundary here is clearly drawn at ADIs with IRB model approval.

The remaining ADIs would be subset into the following:

- Tier 2: ADIs subject to the specific APS 117 risk management requirements
- Tier 3: ADIs subject to the general risk management requirements regarding interest rate risk in the banking book.

COBA proposes that by default all standardised ADIs would be 'Tier 3' and subject to general risk management requirements. Under this approach, APRA would 'opt-in' entities that it believes should be subject to the Tier 2 APS 117 risks management requirements. Utilising APRA's initial rationale, it would be able to 'opt-in' the larger standardised or mid-tier ADIs in question.

This would be a similar approach taken to the proposed simplified capital framework where APRA reserves the right to 'opt-in' entities based upon their business model. This approach would also create an incentive for ADIs to maintain lower amounts of interest rate risk in order to avoid being 'opt-ed in'.⁷

⁷ The APRA 2018 Discussion Paper: Revisions to the capital framework for ADIs notes that "Finally, it is intended that ADIs meeting the proposed criteria would automatically be subject to the simplified framework. However, APRA supervisors would have discretion to require a small ADI to use the more complex framework where appropriate based on the nature of its business".

As a rudimentary cost-benefit, this would mean that only those identified as 'higher risk' would need to incur the costs of 'Tier 2' compliance, while reducing the compliance costs on 'Tier 3' institutions.

COBA believes that such an approach is consistent with the supervisory intentions in the Basel standard:

“The implementation of these principles should be commensurate with the bank’s nature, size and complexity as well as its structure, economic significance and general risk profile. This requires that supervisors gauge their responses where appropriate for banks with low IRRBB profiles. In particular, supervisors will focus on systemic risks that are inherent in large, complex or internationally active banks.”

In addition to the approach proposed above, we have the following comments on the content of the draft APS 117 standard:

- Additional clarity is required around APRA’s expectations regarding the six interest scenarios. These scenarios may not all be done by all ADIs and may not be “commensurate with the nature, scale and complexity” of a smaller ADIs’ operations.
- Potential resourcing issues around the ‘independent’ IRRBB risk management function (para 17) noting that this is likely to be done by a Treasurer-equivalent in a smaller ADI (who many also be contributing to IRRBB) and the requirement for an executive committee which could be excessive for the smallest ADIs.
- There are questions around what guidance will be provided in determining the maturity profile assumed for shareholder’ equity.
- More clarification is required regarding para 19(f) regarding expectations around “the materiality of any IRRBB not captured by the system”.
- Questions around APRA’s ‘proportionality’ in terms of approval to use non-standard maturity pricing assumptions referred to page 15 of the Response Paper. COBA notes that APRA’s standardisation rationale relates to the “unnecessary variability in the IRRBB capital charge”. COBA assumes that given standardised ADIs are not subject to this capital charge, this rationale does not apply, and such this approval is likely to be much less onerous.

COBA notes that more broadly extending the IRRBB risk management requirements to standardised ADIs will also require a revised APG 117 that is appropriate for standardised ADIs and not just for IRB ADIs.

Thank you for the opportunity to comment on APRA’s proposal. Please contact **Redacted** on **Redacted** or **Redacted** to further discuss any matters raised in this submission. **Redacted**

Yours sincerely

Redacted

MICHAEL LAWRENCE
Chief Executive Officer