



Regulation and Interest Rate Risk in the Banking Book

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ALMA Conference - June 2005

Disclaimer

This presentation is wholly a personal view and I am not expressing the view of HBOS or any other organisation.

Agenda Items

- The Current Regulatory Framework
- The Proposed Regulatory Framework
- The Consultation Process.
- The Next Steps

Introductory Question

On Consultation Paper CP 05/3***.....What do the Triple stars *** mean?

Some answers for starters....

High quality

Very high importance or

Nothing at all

Current Regulation

- Buildings Societies
 - Standard Gap Reporting
- Larger Institutions
 - Executive Committee papers
- No Standard Reporting Covering all Financial Institutions

Current Regulation

- Regulation has been increasing
- Driven by.....
 - Basel
 - Significant losses at certain institutions

And some Pillars.....



And some more....



And some more....



Basel II - The Three Pillars



- ▶ Pillar 1: Basic calculation of capital requirements.
- ▶ Pillar 2: Total Capital Estimation Process & Regulatory Oversight.
- ▶ Pillar 3: “Market Discipline” i.e. disclosure in annual report.

Current Dependencies

Agreement by....

EU Council of Ministers

EU Parliament

CEBS (Committee of European Banking Supervisors)

Capital Requirements Directive (CRD)

European Regulatory Agenda

European Legislation

Capital Requirements Directive (CRD) - draft text 14 July 2004

- Followed - Revised Basel Framework - June 2004
- Proposes changes to two existing directives
 - Banking Co-ordination Directive (BCD)
 - Capital Adequacy Directive (CAD)





High Level Requirements

Adequate Capital Resources.....

Economic Value Stress Test with a limit of 20% of own funds

Greater reporting.....andIncreased oversight

Proposed Regulations

- Consultation Paper - CP05/3*** - chapter 9
 - Applying Pillar II
- Discussion Paper - DP05/1
 - Revised standard reporting
- CEBS Driving common Reporting and consistency

Proposed Regulations

- Implementation of Basel Pillars and Regulatory oversight
- CP05/3 - Strengthening Capital Standards
 - Applies Pillar II principals
 - Introduces Standard shock to Economic value
 - Aims to ensure firms have sufficient Capital
 - Reliant on own internal models and works in conjunction with the ICAAP and SREP processes

Proposed Regulation

- CP05/3 - five figures required quarterly
 - Economic Value
 - Economic Value + 200bps
 - Economic Value - 200bps
 - Economic Value % for + 200bps
 - Economic Value % for - 200bps

Proposed Regulation

- DP 05/1 - Standard Regulatory Reporting
 - Covers all aspects of Regulatory Reporting
 - IRRBB only specified in one of a number of tables
 - Forms a standard Gap Report - monthly
 - Separate out Pipeline, Option features, Capital
 - Calculation of Economic Value
 - Comparison to 'Alternative Estimate'

Consultation Process

- Constructive and collaborative debate
- UK ALMA instrumental in initial discussions
- BBA - co-ordinating
- Met prior to FSA meeting then with the FSA
- Draft responses circulated around members
- Presented to FSA

Consultation Process

Industry Response

- No to standard reporting
- Yes to sharing results of shock test on internal models
- Yes to answering further questions or providing additional internal reports
- Waiver to standard report for larger firms
- Redesigned standard report for all others
- Use own internal model assumptions

Consultation Process

Industry Response

- Implications of stress test
- Breach the limit of 20% of own funds the consequences will be
 - Allocation of capital
 - Decrease the risk position

Implementing Basel II Pillar II requirements

- Internal Capital Assessment
 - ICAAP (Individual Capital Adequacy Assessment Process)
 - SREP (Supervisory Review and Evaluation Process)

FSA Implementation Timeline

- January 2005 - First CP
- Mid 2005 - Interim policy statement
- November 2005 - Finalisation of EU text
- February 2006 - Second CP
- Mid 2006 - Policy statement ('near' final rules)
- October 2006 - FSA makes final rules
- 1 January 2007 - Rules take effect

Useful Links

BBA response to CP05/3

www.bba.org.uk/bba/jsp/polopoly.jsp?d=155&a=5689

FSA Policy Documents

www.fsa.gov.uk/Pages/Library/Policy/index.shtml

CEBS

www.c-ebs.org/

UK ALMA

www.ukalma.org.uk



www.hbosplc.com

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