Interest Rate Risk in the Banking Book – Challenging Times

ABN AMRO, Marije Elkenbracht, 28th May 2014

Content

- Positioning in today's markets
- Basic choices in calculating value based metrics
- Prepayment behaviour for mortgages
- Savings

All views expressed in this presentation are of the author and not necessarily of Abn Amro.

marije.elkenbracht@nl.abnamro.com

Positioning in today's markets

10Y swap and 3M Euribor rates

Positioning in today's markets

- Rates will eventually go up, but when?

  - Japan scenario or will rates later this year increase, maybe even sharply?

  - Position optimally for one, and limit the risk for the other, or stay "in between"?

- - Active steering (with equity as a resultant) or

  - Maintain a constant position with an assumed long duration of equity through the cycle?

- What metrics to use? NII-at-Risk, Duration, VaR, scenarios, stress scenarios. Some banks are more steered on NII-at-Risk, others more on Duration.

Basic choices in calculating value based metrics

How to calculate e.g. Duration?

- Include cash-flows based on client contract or based on ftp?
- Do you want to hedge the margin?
- For discounting: do you include a credit spread?
- If you include a credit spread: do you use the actual credit spread or fix the one at inception?
- To what extent do you base your approach on accounting methodology?

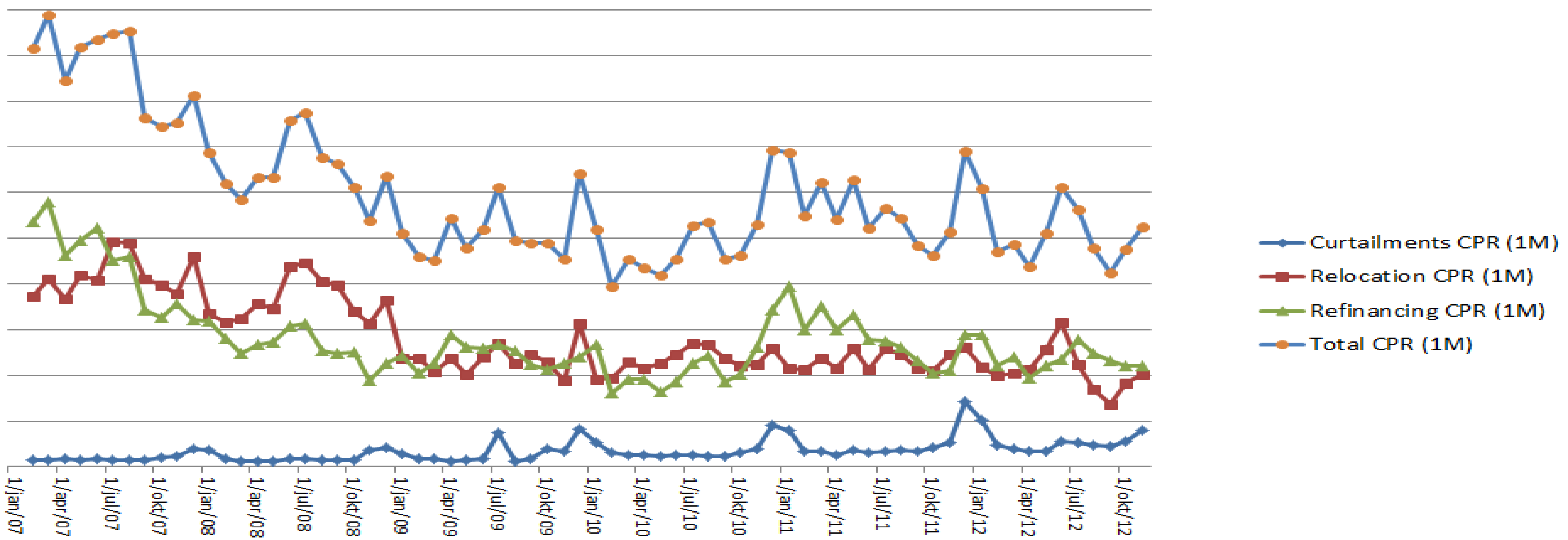
Underlying models

Prepayment and savings models have huge influence on outcome of the metrics.

- Traditionally these models are based on historical data. Still valid?
- Significant changes took place in the underlying markets.

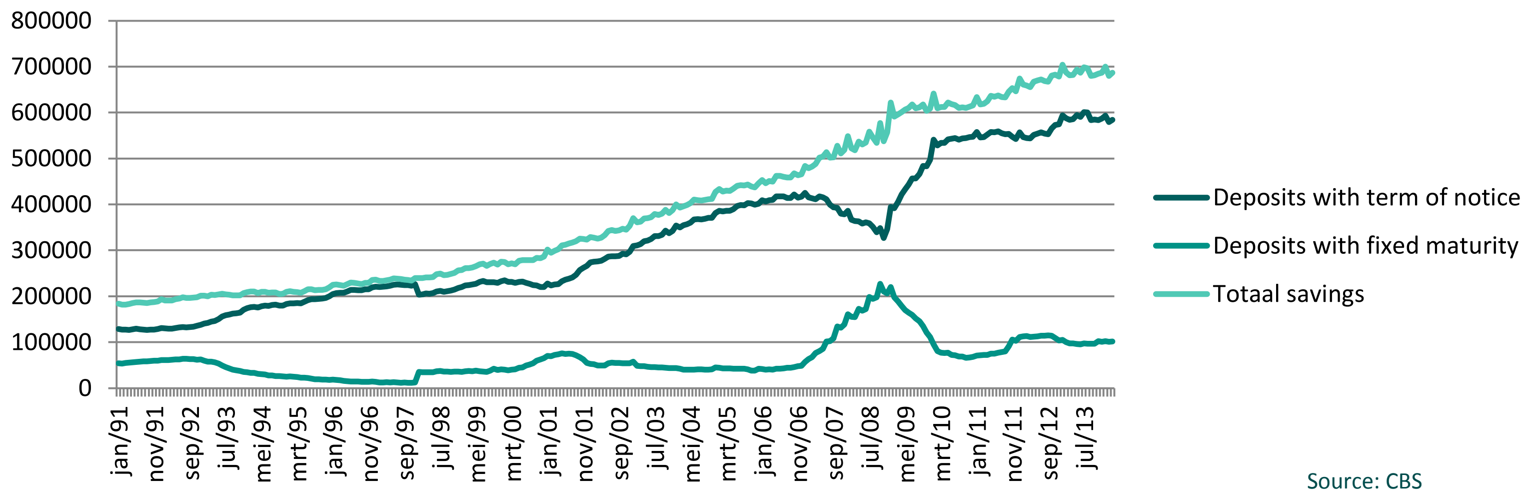
Prepayment behaviour for mortgages

- Significant drop in number of house sales in 2008/2009;
  Relocation and Refinancing: decreased, Curtailments: increased.
- Do we base the model on pre-crisis data?
- Do we need a model that yields different results in short and long term?
- Do we need more models and accept we steer in a band with?



Savings

- Increase of volume has recently topped off.
- Traditional replicating portfolio model most vulnerable when rates increase. Can the yield of the replicating portfolio keep up with the market rates?
- Have customers delayed major purchases? If so, what effect will this have on savings volume when the economy improves?
- What will happen to the savings rates given increased focus on LtD metric?
- Do you build your model based on history, expectation or both?



Source: CBS

Conclusion

Interest rate in the banking book is an extremely interesting and challenging area to work in

- with a lot a stake and
- still many questions with no clear cut answers.

Source: CBS