BNP PARIBAS

M E M O R A N D U M

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TO: CEBS

FROM: C. LAJOIE

COPY: *Commission Bancaire (P.Y. Thoraval)*

OBJET : Bank's comment on CP11

BNP Paribas was closely associated to the French and European Banking Federation comments and fully support them. Nevertheless, we would like to highlight a few points that we consider key for any ruling in relation to the IRRBB and concentration risk.

I. CONCENTRATION RISK

Concentration risk, which is the other side of diversification effect, is both critical to the risk management process and challenging from a methodological stand point. The Large Exposure questionnaire, which also touches upon concentration risk, should contribute significantly to the understanding of the issue and we cannot but recommend not issuing guidelines before a thorough analysis of the Industry answers is completed.

We also believe that the L.E. regime and concentration risk are distinct issues. They have common grounds and should be based on consistent metrics; however they do not share the same objectives. The L.E. regime is designed to be an ultimate safeguard against careless lending, concentration risk management aims at optimizing the credit portfolio structure. Ruling is understandable in the first case; it is inappropriate for the second use. Concentration risk should be mainly a matter of dialogue with the supervisor through the SRP.

As stated above, concentration risk is foremost a management issue which needs to be tailored to the risk profile, the risk appetite and the business nature of the bank. Moreover it should be a dynamic exercise, taking into account recent economic trends and anticipating possible correlated crisis. Systematic and standard analyses would serve no purpose; they would not identify true concentration risk areas; comparisons across banks are deemed to be misleading; they must be avoided. To the contrary, ad hoc analysis, multi-criteria approaches, stress testing should be developed and directed toward decision making: soft limit setting, hedging, mitigating, selling, etc.

Risk internal models deliver an appropriate metric and a common currency to identify and assess risk concentration but these measurements must be supplemented by other techniques in order to challenge the imbedded correlation hypotheses of the models used and to understand better the interaction between primary risks: credit, market, operational. Stress testing is certainly one of the most useful techniques in this regard.

We would finally like to point out that humility should prevail. We are not aware of "generally accepted concentration risk management best practices" and we would be most concerned by too precise guidelines in such a sensitive area.

II THE INTEREST RATE RISK IN THE BANKING BOOK

We believe that the robustness and ability of the bank's internal models to measure, control, monitor and manage the IRRBB should be the primary focus of the supervisors. This is probably the only way to overcome the complexity of the IRRBB; the larger the institution, the truer it is. Any standardized approach is doomed to be misleading and to initiate multiple information requests with little value.

The percentile approach described in IRRBB 5 to calibrate interest rate shocks is an example of the limits of standardization. In case of emerging markets, this method could lead to very unstable and highly dispersed results; the quantitative vision cannot but be supplemented by a more judgmental assessment of the risk involved. The sensitivity of the risk measurement to the scheduling of assets and liabilities with no maturity is another example of the difficulties raised by the IRRBB.

IRRBB is another illustration of the move towards more centralized management of issues, which request expertise and economically benefit of the diversification and compensation existing across products, customers and businesses. We urge again supervisors to consider this risk mainly at the consolidated level; the entity level should be the exception.