BEUC The European Consumer Organisation

The Consumer Voice in Europe

**Mr. William Coen**
Secretary General
Basel Committee on
Banking Supervision
Centralbahnplatz 2
Basel
CH-4002 Switzerland

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Dear Mr. Coen,

I am writing to you on behalf of BEUC, The European Consumer Organisation, which has a membership of 40 well respected, independent national consumer organisations from 31 European countries. We have recently become aware that the Basel Committee is currently reviewing its *Principles for the Management and Supervision of Interest Rate Risk*. According to our information, one of the main changes expected is to impose higher capital requirements on banks that lend predominantly at fixed interest rates, which would have as a consequence that banks will be encouraged to massively switch to variable rate home loans. This issue has had substantial media coverage in the past few months.

Such a policy change would have a tremendous negative impact on consumers in countries with mostly fixed rate home loans because we see a risk that the whole credit risks would be passed on the borrowers. Therefore, we would highly appreciate if you could clarify your approach before possible publication of the above-mentioned Principles, while taking due account of the following questions and considerations.

Fixed rate home loans are widespread in many European Member States and consumers in those countries are particularly attached to this product because it allows them to realise one of the most important projects in their lives – buying a home. Fixed rates are preferred by consumers over variable rates as they guarantee certainty in the long run with fixed monthly repayments. Many households prefer not to opt for variable rate loans, and will probably not borrow if the offer of fixed rates shrinks. Has the Basel Committee assessed the potential negative impact of a shift to variable rates on consumer expectations and confidence?

As far as we understand, the main rational for the Committee's expected recommendation is that fixed rate loans undermine the financial stability of banks because of mismatch between banks' lending and borrowing activities. While we are aware of the underlying arguments such as liquidity risk and interest rate risk faced by banks, we are not convinced that in practice the transmission channel of the risk is as straightforward and simple as presented by the Committee. In particular, is there evidence that the banking sector in countries with predominantly fixed interest rates is more vulnerable and unstable than in countries with predominantly variable rates? Is there any data suggesting that the recent financial turmoil was mostly caused by and impacted more strongly the resilience of the financial sector in fixed rate countries? We notice the opposite – the financial crisis originated in the US and strongly impacted countries such as Spain and UK, where variable rates are dominant.

BUREAU EUROPÉEN DES UNIONS DE CONSOMMATEURS AISBL | DER EUROPÄISCHE VERBRAUCHERVERBAND
Rue d'Arlon 80, B-1040 Brussels • Tel. +32 (0)2 743 15 90 • Fax +32 (0)2 740 28 02 • consumers@beuc.eu • www.beuc.eu
TVA: BE 0422 071 051 • EC register for interest representatives: identification number 9505781573-45

Therefore, in our view, no conclusions can be drawn regarding a causality link between the type of interest rates and banks' stability[1].

From the point of view of The European Consumer Organisation the key requirement of a stable home-loan market is to make lending practices more responsible in order to ensure banks and other creditors provide credit only to those borrowers who are likely to repay their debts. The principles of responsible lending are properly enforced, e.g. in countries like France and Belgium, where fixed rate mortgages are dominant and the share of unpaid loans is very low.

Furthermore, as testified by bank representatives, the mismatch between the rates at which a bank borrows and lends is not necessarily negative for the bank: *"A rising interest rate environment can work to banks' advantage because it provides them with the opportunity to invest non/low-interest bearing deposit liabilities at higher rates."*[2] It is worth mentioning here that consumers' current account balances are usually not remunerated, hence banks benefit from an additional and free of charge funding source.

Also, as banks' cost-benefit structure is complex, one cannot assess their lending and borrowing activity in isolation, without taking into account other activities carried out by banks. It is widely known, that in many national markets home loans play the role of a gateway allowing banks to attract new customers and gain their loyalty. In the long run, most consumers purchase several financial products from their lender, such as current account, savings and investment products, insurances, payment instruments. This means that banking activity is usually widely profitable. As consumer representative, we are not opposed to this business model, providing that consumers always have a choice to take out additional financial products - we do not support tying practices and conditional sales that are often detrimental for consumers.

Furthermore, financial institutions have a wide array of tools at their disposal to hedge against their losses, which is not the case of a consumer who cannot afford to take financial risks all over 15 to 30 years.

We do hope that the consumer perspective will always be taken into account by the Basel Committee when considering any policy measures susceptible of impacting consumer rights and protection.

Yours faithfully,

Monique Goyens
Director General

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[1] The Basel Committee's original Principles for the Management and Supervision of Interest Rate Risk (2004) equally point to numerous factors and assumptions that may impact the interest rate risk measurement.
[2] Letter by the Institute of International Finance and International Banking Federation addressed to the Basel Committee on Banking Supervision, 12 February 2014: www.iif.com/download.php?id=iLf3EcjoKXU=