24 June 2013

Mark Carney
Chairman
Financial Stability Board

Stefan Ingves
Chairman
Basel Committee for Banking Supervision

Bank for International Settlements
CH-4002
Basel, Switzerland

Re: Implementation of Prudential Standards

Dear Chairman Carney and Chairman Ingves:

The Global Financial Markets Association ("GFMA")[1] commends the G-20 Finance Ministers, the Financial Stability Board ("FSB"), and the Basel Committee on Banking Supervision ("BCBS") for their role in encouraging jurisdictions to adopt national regulatory frameworks that are largely harmonized. GFMA represents the common interests of the world's leading financial and capital market participants, including the vast majority of global systemically important banks. GFMA's overarching goal is to coordinate regulatory reform implementation across borders to ensure regulatory arbitrage does not pose a risk to the financial system and to avoid negative extraterritorial effects. The post-crisis international regulatory framework represents a major step forward from that which existed prior to the financial crisis. Your efforts have helped to avoid or mitigate cross-border conflicts, inconsistencies, gaps and duplicative requirements arising from regulatory reform initiatives adopted by jurisdictions in response to the global financial crisis.

As we have entered the implementation phase for many of these regulatory reform initiatives, however, instances of divergence from agreed frameworks have increased. Some jurisdictions have also adopted or are considering additional reforms beyond international consensus (e.g., structural banking reforms). Inconsistent prudential standards, including variations in supervisory practices, and a trend

[1] The Global Financial Markets Association brings together three of the world's leading financial trade associations to address the increasingly important global regulatory agenda and to promote coordinated advocacy efforts. For more information on GFMA, please visit http://gfma.org/about/. The member trade associations count the world's largest financial markets participants as their members. GFMA's Board is comprised of members from China, France, Germany, Italy, the Netherlands, Sweden, Switzerland, the UK, and the US, which engage in business on a global basis.

toward regulatory fragmentation could increase regulatory arbitrage, undercut efforts to develop a credible cross-border resolution regime, and undermine international cooperation on policymaking.[2]

Divergence is already occurring in several significant areas. These areas include the timeline as well as some substantive aspects of Basel III implementation, the application of capital buffers, national regulatory approaches such as the ring-fencing of capital and liquidity, and recovery and resolution planning.

Beyond divergence in implementation, there is increasing interest in some jurisdictions to dispense with or deemphasize use of risk-based capital measures in favor of more simplistic leverage ratios. At least in part, this interest is driven by concerns about the challenges of harmonizing risk-based capital measures across jurisdictions. Nonetheless, risk-based capital measures allocate capital to risk and reflect off-balance sheet exposures in a more effective manner. Notwithstanding the relative merits of risk-based capital measures and leverage ratios, the de-emphasis of risk-based capital measures in certain jurisdictions poses a challenge to international harmonization.

We urge the G-20 Finance Ministers to use the FSB and the standard-setting bodies including the BCBS as a means to promote consistent implementation of international prudential standards and to stem the trend towards regulatory fragmentation. As described in more detail below, we believe the FSB and BCBS could accomplish this through more robust peer reviews, targeted quantitative impact studies, recalibration of rules where national variations have exposed deficiencies in the original proposals, and additional operational guidance. In some cases, this may require delayed effective dates in order to allow time for proper coordination.

Though by no means exhaustive, we describe a number of current initiatives where additional coordination is particularly important.

I. The FSB and BCBS should encourage all jurisdictions to adhere as closely as possible to uniform Basel III implementation and, where necessary, facilitate consensus on major implementation differences.

BCBS member jurisdictions have made substantial progress in meeting the Basel III implementation timetable, and there are now grounds for believing that all major jurisdictions will implement Basel III in full by 2019. Just as significantly, banks have dramatically increased capital well-ahead of the Basel III timetable; the largest banks in the world reduced their capital shortfalls under Basel III by over €175 billion in the six-month period ending 30 June 2012.[3] Although some timing divergence by jurisdictions may be expected, it would be helpful if discrepancies could be kept to a minimum, in terms of both leading and lagging the timeline.

[2] We intend to address our concerns with global consistency of securities and derivatives regulation in a separate letter.

[3] See BCBS, "Report to G20 Finance Ministers and Central Bank Governors on monitoring implementation of Basel III regulatory reform" (April 2013), available at http://www.bis.org/publ/bcbs249.pdf.

The BCBS progress reports are a useful tool for encouraging uniform Basel III implementation, and robust FSB or BCBS peer reviews, combined with quantitative impact studies comparing differing implementation approaches as needed, can identify material differences in both the timing and nature of implementation. However, where there are material variances, the BCBS should seek to reconcile them. If national authorities deviate from their agreement to implement the Basel III proposals, it may represent valid implementation concerns. The BCBS should first identify the reasons for deviation and then determine if either: (i) a general adjustment is warranted to the rules; or (ii) a well-documented specific adjustment should be published reflecting a particular set of circumstances.

As an illustration of the former, the BCBS made a general adjustment to the rules in respect of the Liquidity Coverage Ratio ("LCR") where it was evident from a number of national and regional implementations that general modifications would be appropriate. This was entirely in line with the review process put in place when the LCR was originally published in December 2010, including an extended observation period to ensure proper design and calibration and to address any unintended consequences.

The BCBS should be willing to make adjustments to mitigate the risk of regulatory divergence when there is a developing understanding of unintended consequences and some jurisdictions make what they consider to be appropriate adjustments to the standards, but others do not. These may be at both a principle and a technical level and both can have material effects in terms of the outcomes.

A notable recent example is the divergence between the European and US positions on the implementation of the capital treatment of credit valuation adjustment ("CVA") risk. The EU has determined that the overall calibration was wrong and agreed to exempt certain transactions from the CVA capital charge altogether. Responding to similar concerns, US regulators are instead reviewing enhancements to methodology, such as broader recognition of hedges. Where, as here, similar wide-spread concerns are producing different solutions, the BCBS should revisit the regulatory treatment concerned, with a view to promoting a consistent, but still prudent, approach that does not negatively impact financial stability. We therefore urge the BCBS to reconsider the CVA charge as soon as possible.

There are many other examples of both principle and technical divergence including in the areas of the definition of capital; the application of the rules in respect of immaterial holdings and a firm's own shares; and various risk weights. Although these and other deviations in the rules are being documented in the current peer reviews, continuous monitoring should also cover (i) the underlying technical standards and guidance that is provided, and (ii) the application of those standards across the industry given the scope for exemptions and super-equivalence that has been built into national and supra-national standards.

At the same time, the FSB and BCBS need to recognize that there are some circumstances in which the Basel III standards simply cannot be applied because of local circumstances. An example is where national governments are not major debt issuers and a local adjustment to the LCR is clearly required. We believe that these specific adjustments need to be properly reviewed and documented so that other countries can adopt similar solutions if faced with the same issues.

II. The FSB and BCBS should provide additional guidance to jurisdictions regarding systemic buffers, whether in the form of G-SIB or D-SIB surcharges, or individual national frameworks, with an emphasis on ensuring a consistent and transparent approach.

Although there is an agreed implementation date of 1 January 2016 for the G-SIB and D-SIB capital buffers to take hold, some jurisdictions are allowing regulators to accelerate the implementation. It is not clear how much additional guidance will be forthcoming from the BCBS or FSB to ensure a consistent and harmonized approach to implementation. For example, there are questions about how the G-SIB and D-SIB buffers would interact and how they should be applied to parts of the same group. As noted in a recent speech by Paul Tucker on "Resolution and the future of finance" on 20 May 2013, the FSB's distinction between banks structured for a single or multiple point of entry has made the implementation of systemic buffers more relevant.

In addition, there is some indication that certain jurisdictions, in particular in Europe, might want to increase the buffers unilaterally. Currently in the process of being finalized for implementation in 1 January 2014, CRD IV/CRR effectively includes not only G-SIB and D-SIB surcharges commencing in 2016 but also a "systemic risk buffer" at national discretion. CRD IV/CRR also raises the possibility for the European Commission or a national supervisor to temporarily enhance prudential requirements from 2014. We are concerned that these additional measures encourage undesirable "gold-plating" and result in an un-level playing field. While national circumstances will differ, similar conditions should lead to consistent policy responses. We encourage the FSB and BCBS to develop and issue guidance sufficient to ensure a harmonized global approach from the outset, and also incorporate the issue of systemic buffers into its future implementation reviews.

III. The FSB and BCBS should oppose national regulatory approaches that undermine international consistency, such as the Federal Reserve's proposal on *Enhanced Prudential Standards and Early Remediation Requirements for Foreign Banking Organizations and Foreign Nonbank Financial Companies*.

National regulatory approaches with particular attention on capital and liquidity are another area in which we are witnessing divergence. The Federal Reserve's proposal on *Enhanced Prudential Standards and Early Remediation Requirements for Foreign Banking Organizations and Foreign Nonbank Financial Companies* is the most recent example. These initiatives are self-reinforcing; as the Federal Reserve notes, its proposal is in part a response to actions of other home country supervisors that call into question the assumption that foreign banks will be able to serve as a source of support to their overseas operations. There is a significant risk that other jurisdictions will respond to the US initiatives in kind.

While these initiatives may have some appeal or logic at the national level, they require duplicative, and possibly inconsistent, capital and funding regimes. Ultimately, this may undermine local and international financial stability in both the short and long term. As noted in our comment letter to the Federal Reserve,[4] rigid capital and liquidity management by geography frustrates their flow to areas

[4] GFMA Comment Letter to the Federal Reserve on the Proposed Rule on Enhanced Prudential Standards and Early Remediation Requirements for Foreign Banking Organizations and Foreign Nonbank Financial Companies (26 April 2013), available at http://www.gfma.org/correspondence/item.aspx?id=472.

most in need during a crisis, upsets coordination of home-host supervisory responsibilities, undercuts FSB efforts to encourage the development of credible cross-border resolution plans as well as the plans themselves, and requires costly, overlapping, and potentially inconsistent compliance regimes between home and host countries.

We have urged the Federal Reserve to lead an international effort to oppose national regulatory approaches in all jurisdictions rather than respond in kind. Regardless, the FSB and BCBS have a fundamental interest in averting this trend. Accordingly, we strongly believe the FSB and BCBS should use every means at their disposal to address the concerns motivating these initiatives in an internationally-coordinated manner that does not undermine the global nature of our financial system.

IV. The FSB should continue to push forward with agreement on common recovery and resolution principles and work towards clear and transparent supervisory expectations and delineation of responsibilities of home and host authorities.

We strongly support the FSB's work on recovery and resolution planning, including its most recent Consultative Document on *Recovery and Resolution Planning: Making the Key Attributes Requirements Operational*. As we have previously noted,[5] the FSB's efforts to assemble a single comprehensive and cohesive package of policy measures to improve the capacity of authorities to resolve SIFIs within and across national borders have paved the way for the considerable progress made by the United States and Europe over the past two years in recovery and resolution planning.

That being said, the FSB's continuing involvement and leadership is critical to avoid ill-defined or opaque recovery and resolution protocols in jurisdictions. Without real coordination and transparent expectations, internationally-active firms are likely to face a number of distinct and possibly conflicting recovery and resolution planning requirements at the consolidated level and in each major jurisdiction or, perhaps worse, be held to unknown standards. For example, the EU's draft crisis management directive on recovery and resolution planning provides member states significant discretion to establish their own supervisory expectations. We encourage the FSB to continue operationalizing its *Key Attributes*, including supervisory expectations and delineation of the responsibilities of home and host authorities, as well as monitoring and assessing compliance with the *Key Attributes* by jurisdiction through a robust peer review process.

Conclusion

The global financial crisis spawned a host of regulatory reform initiatives. The G-20 Finance Ministers, acting in concert with or through the FSB and BCBS, have done much to harmonize these initiatives. These efforts have reduced the possibility of cross-border conflicts, inconsistencies, gaps and duplicative requirements and helped maintain a level playing field for internationally-active banks.

However, as national supervisors embark on implementation, it is critical that the G-20 Finance Ministers, FSB, and BCBS use every available means – whether robust peer reviews, recalibration in

[5] GFMA Comment Letter to the FSB on the Consultative Document on *Recovery and Resolution Planning: Making the Key Attributes Requirements Operational* (7 Dec. 2012), available at http://www.gfma.org/correspondence/item.aspx?id=386.

international forums, etc. – to ensure implementation at the national level does not undermine the harmonization achieved at the international level. Delays in implementation are acceptable if they contribute to consistency. We understand that the diversity of banks and banking models may require some national specificity, but we believe well-calibrated, internationally-agreed standards are an important element of financial stability. In addition, some jurisdictions are embracing functional and geographical ring-fencing models that undermine international regulatory cooperation, increase fragmentation of the global banking system, and ultimately weaken global financial stability, with a corresponding adverse impact on their own stability.

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GFMA recognizes the challenges of achieving and maintaining international harmonization of financial regulations. We believe the industry can and should assist in the process and GFMA stands ready to help in any way we can. Specific initiatives could include member surveys of implementation progress and expert working groups to advise on highly technical rules such as those dealing with risk-based exposures. It is in all of our collective interest to develop a robust, sustainable prudential framework for global financial institutions.

GFMA appreciates your consideration of these important issues.

Sincerely,

Simon Lewis
CEO
GFMA

CC: G20 Finance Ministers