Mr. Mario Draghi  
Chairman  
Group of Governors and Heads of Supervision  
Bank for International Settlements  
Centralbahnplatz 2  
CH-4002, Basel, Switzerland  

Re: Finalising International Risk-Based Capital Requirements  

Chairman Draghi:

As the Basel Committee nears finalisation of its overhaul of the international risk-based capital framework, the Global Financial Markets Association (GFMA) believes that it is necessary to write to you in your capacity as Chair of the Group of Governors and Heads of Supervision (GHOS). It is important to note that we support appropriately calibrated global minimum standards. More specifically, we endorse the Committee’s objective in revising the risk-based capital framework to achieve an appropriate balance between its risk sensitivity, simplicity and comparability and we welcome the GHOS commitment that these revisions should not, in aggregate, lead to a significant increase in overall capital levels.

Furthermore, we understand the considerable work that the Committee is undertaking to meet its goal of finalising the proposals by the end of this year, and look forward to greater regulatory certainty after a lengthy period of reform. Nevertheless, we regret that this year-end deadline implies that fundamental revisions to the key part of the risk-based capital framework will have been made while relying upon only one QIS exercise. Notwithstanding material revisions to the original proposals which we understand are being actively considered, the information currently available suggests that significant capital increases will still apply to a population of banks that is too broad to be considered outliers. We also remain concerned that the initial QIS lacks the granularity to assess with certainty the impact of these changes and that the framework itself may still not be sufficiently risk sensitive to the underlying risks in different product markets. Transparency on how the Committee reaches its final decisions will therefore be important for the credibility of the reform and its ability to restore trust in the adequacy of bank capital levels.

Beyond changes to the risk-based framework itself, we do not believe the introduction of an output capital floor is necessary. The leverage ratio is already a non-risk sensitive backstop to address model risk. Moreover, RWA variance not attributable to differences in underlying risk levels is in the process of being addressed not least through the present package as well as through various other avenues.

Given the substantial nature of the changes that will be proposed we recommend that, as governing body of the Basel Committee, the GHOS carry out several immediate actions. Firstly, it should require the Committee to conduct a comprehensive and transparent quantitative analysis of the package once it is finalised, to understand whether it has delivered all its objectives, including that of not significantly increasing overall capital requirements after taking account of the impact of the FRTB together with the other proposals on credit and operational risk. This exercise should be assessed on both a global and regional basis to take account of local market specificities. It should also ensure that the framework retains sufficient risk sensitivity to avoid distorting capital allocation decisions and pricing to the detriment of banks’ customers and the global economy. It is important this analysis be sufficiently granular to identify any issues that occur at the level of products, business models and jurisdictions, including emerging markets. Secondly, it should provide the
Committee with a clear mandate to address any such deficiencies this exercise identifies. Thirdly, the GHOS should ensure that sufficient lead time is provided by the Committee for these revised standards to be implemented after any necessary corrections are made, bearing in mind that once Basel standards are finalised, markets tend to hold banks to immediate, fully-loaded compliance rather than to specified implementation dates. Finally, it is essential these steps be clearly communicated to stakeholders at the outset to avoid creating market expectations whereby banks may be assessed against standards that are neither consistent with the intent of the regulations, nor the stated objectives of the G20 to not result in significant increase of capital.

In addition to the above, the GHOS should ensure that the Committee fulfils its commitment to undertake a comprehensive review of the interactions, coherence and calibration of the overall regulatory reform framework to ensure that the rules achieve, what was originally intended and address any instances of inconsistency, duplication or overlapping requirements which might otherwise result in undesired outcomes and notably banks’ inability to play their economic role. The exercise will inevitably need to be carried out over a time period that is sufficient to understand the impacts of the rules under different market conditions and over longer economic cycles.

To conclude, we reaffirm our offer to support the Committee’s efforts in any way we can so that the Basel Committee continues to deliver high quality global standards. It is crucial for these standards to strike the right balance between the objectives of financial stability and the need for a robust and vibrant banking sector to take appropriate risks to support the global economy. It is also vital that they gain a strong level of acceptance as appropriate minimum standards to facilitate consistent implementation across all Basel jurisdictions. Such acceptance will require their impact to be assessed both at a global and regional level to ensure that such consistency takes account of local market specificities.

Sincerely,

Mark Austen
CEO
Global Financial Markets Association

c:  Stefan Ingves, Chairman, Basel Committee on Banking Supervision
    William Coen, Secretary General, Basel Committee on Banking Supervision