June 30, 2017

Secretariat of the Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel
Switzerland

Re: BCBS Consultative Document: Global systemically important banks – revised assessment framework

Dear Sirs and Madams,

The Global Financial Markets Association (GFMA)\(^1\) appreciates the opportunity to comment on the BCBS's consultative document “Global systemically important banks – revised assessment framework” (d402). The proposal seeks to adjust the methodology for assessing a Global systemically important bank's (G-SIBs) contribution to systemic risk and to mitigate the impact of its distress or failure on the financial system. In doing so, there will be changes to the higher loss absorbing (HLA) capital requirements of individual G-SIBs.

Whilst we are supportive of a review of the framework, we believe that changes to the methodology do not result in an increase in the level of system wide capital requirements\(^2\) as it is broadly recognised that there is sufficient capital in the banking system and the focus of prudential regulation going forwards should be on coherence of regulatory capital requirements. In this regard, the proposed changes should not address risks which are already addressed elsewhere in the prudential framework and give rise to duplicative requirements.

It is crucial to recognise that the G-SIB buffer, which is a capital measure, is not the only tool – and certainly not the most effective tool – to address and mitigate the negative externalities associated with institutions perceived as too big to fail (due to their size, interconnectedness, complexity, lack of substitutability or global scope). In particular, it is vital to recognise the measures adopted with a view to reduce the impact of failure of large banking groups and ensure there is no moral hazard arising from any perceived public support – to this end, the FSB has created an overarching resolution framework and principles, including a standard on loss absorbency capacity for G-SIBs. This is at advanced stages of implementation (will be in place in 2021) and GSIBs have been taking important steps towards the build-up of an effective resolution strategy and the issuance of Total Loss Absorbency Capacity, reducing the impact of failure and ensuring orderly resolution of the group without interruption of critical economic activities and without

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\(^1\)GFMA 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. The Association for Financial Markets in Europe (AFME) in London and Brussels, the Asia Securities Industry & Financial Markets Association (ASIFMA) in Hong Kong and the Securities Industry and Financial Markets Association (SIFMA) in New York and Washington are, respectively, the European, Asian and North American members of GFMA. For more information, please visit [http://www.gfma.org](http://www.gfma.org)

\(^2\)G20 leaders commitment at the September 2017 Hangzhou Summit: “We reiterate our support for the work by the Basel Committee on Banking Supervision (BCBS) to finalize the Basel III framework by the end of 2016, without further significantly increasing overall capital requirements across the banking sector, while promoting a level playing field” – see §18 of [http://europa.eu/rapid/press-release_STATEMENT-16-2967_en.htm](http://europa.eu/rapid/press-release_STATEMENT-16-2967_en.htm)
recourse to public funds. Measures taken to improve resolvability should therefore be taken into account in the G-SIB methodology, and a downward recalibration would be justified.

Banks are now much better capitalized and resolvable, riskier businesses and funding sources are less prominent, bank resolution schemes have progressed substantially, and Banking Union in Europe has significantly progressed. Accordingly, we believe that the cumulative amount of systemic risk in the banking sector has been reduced, including in Europe.

The proposed amendments do not seem, however, to reflect the sizeable reduction that has been achieved, and the same amount of perceived systemic risk is simply being re-allocated across the cohort of GSIBs. Similarly, the proposed amendments do not consider the migration or expansion of financial activities outside of the banking sector. Accordingly, we believe the review of this methodology should reconsider the GSIB footprint within the whole financial system, taken into account the improvement of the banking framework and the decrease of banking sector importance within the financial system. In this context, we believe the Committee should continue to pursue the objective assigned in 2013 to “capture developments in the banking sector and any progress in methods and approaches for measuring systemic importance,” and to refresh and update accordingly.

We emphasize that non-bank activities should be regulated directly, not through banks exposures which further accelerate activities migration to the so-called shadow banking. We stress also that structural changes should immediately be taken into account and should not unduly penalise banks, clients and growth. This includes, for instance, reduced system wide risk through the significant shift from bilateral to central clearing.

We detail in the subsequent sections our views on the current proposals and highlight where we believe the proposed methodology would benefit from further adjustments / re-consideration.

Q1. What are respondents' views on each of the proposed changes in the G-SIB assessment methodology?

**Removal of the cap on the substitutability category**

The Committee noted in the assessment methodology first established in July 2013, that relative to other categories that make up the G-SIB assessment framework, the substitutability category has a greater impact on the assessment of systemic importance than the Committee had intended for banks that are active in the provision of payment, underwriting and asset custody services. As such, a cap was applied to the substitutability category to reflect flaws in the calibration of the substitutability category.

The Committee stated at that time that “The cap will be reconsidered as part of the first three-year-review. Revisions to the methodology may allow it to be removed at that time.” (bcbs255, footnote 10).

The BCBS has not provided analysis to show that the substitutability category no longer has a greater impact on the assessment of systemic importance than was intended, nor have there been

3[^http://www.bis.org/publ/bcbs255.pdf]

4[^http://www.bis.org/publ/bcbs255.pdf]
any changes to the substitutability category methodology. As such, the basis for the removal of the cap appears inconsistent with the Committee’s own criteria for re-assessment and with its assessment of a flawed calibration in July 2013.

Whilst we are of the view that the cap should not be a permanent feature of the assessment framework, we believe the cap should remain in place until such a time as the substitutability category has been recalibrated to better align the impact on banks which are dominant in the provision of payment, underwriting and asset custody services. This includes a more careful assessment of the systemic risk profile of these activities.

We recommend, whilst maintaining the cap, the Committee consults on a recalibration of the substitutability category. This should be undertaken in conjunction with a review of the calibration of the overall framework to ensure that the Committee accounts for changes in the presence and distribution of systemic risk within the financial system, and to ensure that there is no statistical bias in favour of any one category.

As part of the recalibration, the Committee should recognise that the substitutability of certain products and services is substantially mitigated through a credible resolution plan. We emphasise, in this respect, that banks with significant payment, clearance and settlement activities are held to higher requirements to ensure that their resolution strategies are executable, and ensure both operational continuity and maintenance of connectivity with financial market utilities (FMUs) and agent banks.

If the banks that are currently most active in in the provision of payment, underwriting and asset custody services are forced to reduce their presence in the market due to the cap being removed on the substitutability category without recalibration, it is unlikely that other market participants that are not scaled providers would be able to “step in”, leaving the global economy underserved in these essential products and services. On the other hand, recalibrating the indicator (or retaining the cap), however, would help preserve an incentive for banks to keep providing these essential services which help to preserve financial stability and provide liquidity in financial markets.

**Expansion of the scope of consolidation to include insurance subsidiaries**

We oppose the inclusion of insurance subsidiaries in the scope of consolidation as we do not believe it is consistent with the Basel capital framework, which expressly excludes insurance subsidiaries from the prudential scope of consolidation:

“financial activities do not include insurance activities and financial entities do not include insurance entities” bcbs128, page 6, footnote 7

The deconsolidation of insurance subsidiaries for regulatory capital adequacy purposes requires the deduction of the post-acquisition reserves, leaving the investment in these subsidiaries to be recorded at cost and deducted from CET 1 (subject to thresholds). Furthermore, the treatment of these holdings in insurance subsidiaries as investments means that post-acquisition reserves

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5More generally, the process for establishing the elements of the framework to be revised lacks transparency. There is a lack of justification and statistical analysis to support the decision to review the aspects chosen for review and we believe this needs to be made clear in any future consultations.

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are excluded from Group capital. As such, we believe that prudential capital requirements already
reflect group-wide risk, including insurance interests. The inclusion of insurance subsidiaries for
the purposes of the G-SIB assessment methodology would therefore result in duplicative
requirements.

We believe therefore, that it would be inappropriate to include insurance subsidiaries within the
scope of consolidation of a banking group.

The Committee cites reducing the potential for regulatory arbitrage arising from banking groups
moving insurance activities into their insurance subsidiaries, as one of the outcomes from
incorporating insurance activity in the G-SIB assessment methodology. We believe the issue of
regulatory arbitrage (if established on this topic) should be addressed through greater
cooperation between insurance and banking supervisors. Greater convergence between
insurance and banking supervision was raised as an issue in 2004 by BIS\(^6\) and progress has been
made subsequently. Remaining regulatory arbitrage should therefore be addressed through
strengthening convergence of regulation and cooperation between supervisors, applying across
the whole banking and insurance sector, and not by extending the scope of consolidation for
systemic risk assessment purposes.

Lastly, the BCBS should not pre-empt the current ongoing work that is underway at the
International Association of Insurance Supervisors (IAIS) level regarding the G-SII framework.

It is worth mentioning that insurance entities are subject to a distinct sectorial regulatory
framework, regardless of whether these entities are independent or subsidiaries of banking
groups. This is particularly the case in the European Union (EU), where insurance entities are
supervised, regulated and subject to a specific framework for resolution. Additionally, to assess
the systemicity of a banking group owning insurance entities, those groups forming financial
conglomerates are subject to the EU directive on supervision of financial conglomerates.

Furthermore, insurance activities provide a diversification benefit to banking activities. This has
been shown by numerous studies, which show that there is little positive correlation between
insurance and banking activities. The ECB notes in its December 2009 Financial Stability Review
that “this is mainly because most insurers’ balance sheets, unlike those of banks, are composed of
illiquid liabilities that protect insurers against the risk of rapid liquidity shortages that can and
do confront banks.” Indeed, holdings in insurance activities proved to be a stabilising factor
during the crisis. Those insurers that were most significantly hit by the crisis, were impacted due
to their ‘shadow banking’ activities.

Should the BCBS seek to address the issue of the systemicity of insurance activities, or the risk
that insurance performs shadow banking activities, this should be addressed through specific
sectoral rules and not by further constraining banks for risks that are outside the scope of banking
risks. The BCBS, jointly with the IAIS, should rather identify those jurisdictions where there is a
clear need to reinforce sectoral rules for insurance. Inclusion in the G-SIB assessment framework
would otherwise double count / penalise twice activities already covered in regulated
jurisdictions.

\(^6\)http://www.bis.org/speeches/sp041006.htm
Amendments to the definition of cross-jurisdictional activity

It is encouraging to note enhancements to the BIS’s collection of consolidated banking statistics of liabilities and we support the desire to use higher quality and harmonised data. However, we believe there is an overlap in the inclusion of derivative exposures across the different categories in the assessment methodology which requires attention:

Overlap of indicators – derivative exposures

Derivative exposures are already captured via the complexity, size and interconnectedness categories. Therefore, the risk which is being captured through the inclusion of derivatives has already been capitalised and should not be accounted for once more i.e. derivative exposures should be excluded from the cross-jurisdictional activity.

At a minimum, the Committee should exclude centrally cleared derivatives exposures and derivative exposures to non-financial corporations. In respect of centrally cleared derivative exposures, there should be a recognition of reforms to OTC derivative markets, such that substantial amounts of derivatives are now centrally cleared through central counterparties, reducing the systemic risks resulting from bilateral trading, which was not the case when the current GSIB assessment methodology was finalised.

In addition, we believe that there are issues with the existing methodology which have not been addressed through the proposed changes which require attention:

Treatment of local claims

The methodology currently treats all assets and liabilities of foreign entities of G-SIBs as cross-border relative to the jurisdiction of the holding company/group headquarters. As such, lending by a foreign entity to a local customer, would currently be treated as ‘cross-jurisdictional’ as the holding company or group headquarters reside in a different country.

From a supervisory perspective, once other indicators of systemic relevance like size or interconnectedness are taken into account, local claims and liabilities are unlikely to have any more systemic relevance for foreign subsidiaries than they have for a local bank. A foreign subsidiary with a balanced position in the local currency is not riskier than a local bank in terms of systemicity. There should be due effort therefore, to ensure that banks operating in the same national markets are not put on different grounds. In particular, it should not be the case that local claims and liabilities of a subsidiary of a cross border bank have a different relevance in terms of regulatory requirements with respect to claims and liabilities of domestic banks, because this would adversely affect competition in the domestic market. Therefore, local claims and liabilities should be excluded in the calculation of cross-jurisdictional activities.

We welcome the enhancements to the BIS international banking statistics approved by the Global Financial System (CGFS) in September 2015, which introduces additional information that could enable the Committee to enhance the quality of the cross-jurisdictional indicator by excluding activities performed locally by an affiliate in local currency. Indeed, the statistics collect banks’ local positions – positions against residents of the country where they are located – in local currency, to complement the existing data on local positions in foreign currencies. Whilst this is a positive development, the G-SIB data templates need to be adapted accordingly (to the BS statistic information) for banks to report this information and subsequently have the information
at entity level in order to use this information to address the treatment of local positions of foreign affiliates in local currency within the cross-jurisdictional indicator.

Indicative analysis of public data\(^7\) highlights that local liabilities, in instances, contribute to over 50% of the cross-jurisdictional liabilities indicator. As such, the impact on categorisation can be material and we encourage the Committee to review inclusion of local claims and liabilities in the cross-jurisdictional indicator.

If the BCBS still intends to include local claims and liabilities of foreign subsidiaries among the indicators of global activities, local claims should be at least evaluated net of local liabilities.

**Cross-border activity between EU member states**

Currently, cross-border activity between Member States of the EU is recognised as "Cross-jurisdictional activity". This means intra-Banking Union activities (and *a fortiori* intra-EU exposures) are accounted for under the cross-border activity indicator, thereby artificially increasing the systemic relevance of Banking Union firms.

We recall that one of the underlying objectives of the cross-border indicator was to take into account the risk that the resolution of a multi-jurisdiction banking group would be technically more difficult in case of failure, and that an additional capital buffer was therefore warranted. According to the BCBS: "*The greater a bank’s global reach, the more difficult it is to coordinate its resolution and the more widespread the spillover effects from its failure*"\(^8\). However, such an approach denies the importance of the adoption of the FSB’s Key Attributes of Effective Resolution Regimes for Financial Institutions ("key attributes") endorsed by the G20 Heads of States and Government in November 2011 (as supplemented by the FBS’s added guidance in 2014). The objective of the key attributes is precisely to make feasible the resolution of financial institutions without severe systemic disruption. This is achieved by providing, amongst other key aspects, for a legal requirement for co-operation, information exchange and coordination domestically and with foreign resolution authorities before and during resolution. Resolution regimes are being implemented in accordance with these international standards and the progress achieved needs to be reflected in the G-SIB framework.

In particular, under the key attributes, G-SIBs are subject to resolvability assessments that evaluate the feasibility of resolution strategies by resolution authorities. To the extent resolution authorities deem necessary, they should have the powers to require commensurate changes to a firm’s business practices, structure or organisation to reduce the complexity and costliness of resolution and enable the continued operations of systemically important functions – this may involve evaluating whether to require that these functions be segregated in legally and operationally independent entities that are shielded from group problems. It seems logical that any concerns around the resolvability of a G-SIB are evaluated within this framework and that the G-SIB framework is consistent with the wider resolution framework.

Additionally, since the Banking Union is now a single supervised jurisdiction with the setup of the Single Supervisory Mechanism (SSM) and Single Resolution Mechanism (SRM), this risk is no

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\(^7\)Based on End-2016 G-SIB assessment templates, comparing local liabilities in local currency per section 13.b. with the total cross-jurisdictional liabilities indicator per section 13.c. 

\(^8\)BCBS G-SIB methodology update July 2013 §21 - [http://www.bis.org/publ/bcbs255.pdf](http://www.bis.org/publ/bcbs255.pdf)
longer relevant for intra-Banking Union transactions. We note also that this was anticipated by the BCBS itself: "As regards the structural changes in regional arrangements – in particular, the European Union – they will be reviewed as actual changes are made."\(^9\) Intra-Banking Union activities should therefore no longer be taken into account in the measure of cross-border activity.

Ideally, the entire EU would be considered as a single jurisdiction. Indeed, the EU has set a Single Rulebook (CRR, CRD, BRRD) that is applied cross-border to all relevant institutions within the EU by competent authorities and the European Banking Authority (EBA) contributes to it through the adoption of binding Technical Standards and Guidelines. The EBA also plays an important role in promoting convergence of supervisory practices to ensure a harmonised application of prudential rules.

At the very least, we recommend that intra-Eurozone (Banking Union) exposures be scoped out of the cross-border exposure measures.

**Modification of the weights in the substitutability category and introduction of a trading volume indicator**

We object to the inclusion of a trading volume indicator and believe this indicator is unreliable due to its volatile nature. We are particularly concerned about the requirement to capture intragroup trades, as this is inconsistent with the overall scope of the framework, which is based on consolidated data. The complexity of requiring institutions to report trading volumes, especially with the inclusion of an intragroup dimension will inevitably lead to different interpretations and submissions with poor data quality. This would contravene Principle 2 as well as Principle 3 of the Guiding principles for review of G-SIB assessment methodology. We also note that similar indicators have been considered by individual jurisdictions\(^10\) and criticised for lack of reliability.

Additionally, the Consultative Document states that trading activities of banks sustain market liquidity and a disruption to market liquidity can lead to dislocation of markets. We believe the capital charge associated to trading activities is adequately dealt with in the prudential framework and has already resulted in significant reduction of inventories. Additional requirements in this area would only lead to margin pressure on trading activity, which in turn would further reduce market liquidity - the very area this indicator is aiming to protect. We outline in Question 2 below areas of the prudential framework we believe address liquidity risk.

**Revisions to the disclosure requirements**

We appreciate due consideration of the reporting teams producing the annual reporting accounts and Pillar 3 returns simultaneously, and welcome the sign-posting requirement under the

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\(^9\)BCBS G-SIB methodology update July 2013 §39 - [http://www.bis.org/publ/bcbs255.pdf](http://www.bis.org/publ/bcbs255.pdf)


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updated Basel Committee standards for Pillar 3\textsuperscript{1}, allowing continued disclosure of indicators no later than four months after a bank's financial year end. In respect of the requirement to restate figures if altered as a result of the data quality review from June to August, we appreciate and understand that this can also be met via an update of the web link to the corporate website (that we expect to signpost in the Pillar 3) and/or a regulatory news service feed. Additionally, we would find it helpful if the FSB/Bank of International Settlements (BIS) could publish a final excel book including all the finalised bank indicators (at least of those designated as a GSIB since the disclosures for other institutions are available on the BIS website), and the final scores (since these can be easily calculated and are published, at any rate, on public research sites).

**Further guidance of bucket migration and associated HLA charge**

We are supportive of the change to allow banks to immediately adhere to a lower HLA capital requirement in circumstances where the G-SIB score falls, subject to national discretion. This is a positive move and will help to counter the risk of over-capitalisation of the global financial system, with the associated cost to equity, and allow banks to allocate capital efficiently and in a more timely manner.

Further clarity as to the effective date for the additional guidance would be beneficial. It is our understanding that the further guidance applies to the existing assessment methodology as well as the revised assessment methodology to be published in 2017. As such, the further guidance of bucket migration would be applicable for the first assessment performed post finalisation of the revised assessment framework.

**Transitional Schedule**

Any delay in finalization of this revised methodology should be accompanied by an update of the initial schedule in consequence.

Q2. **What are respondents' views on potentially including STWF as an indicator in the interconnectedness category?**

The Committee is also seeking feedback on the introduction of a new indicator for short-term wholesale funding

The risks that it seeks to address are addressed by other areas of the prudential framework and therefore would result in duplicative requirements. As such, we do not support inclusion of this new indicator.

The BCBS highlights the risk of large scale asset sales to raise funding during periods of stress as a concern. In a funding context, this is countered by higher amounts of stable funding required against wholesale assets for NSFR, and stress related assumptions included in the LCR to ensure that outflows or amounts of funding that can be raised from asset sales and repo operations are sufficient for banks to meet their liabilities as they fall due over a 90-day period. If there is a

\textsuperscript{1}http://www.bis.org/bcbs/publ/d400.pdf

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Different risk appetite underpinning this concern, it should be articulated; as currently stated we would see any additional capital buffer as duplicative.

Fire sale of assets suppressing asset values across the market can indeed give rise to financial impacts at other market participants e.g. through fire sale of collateral assets. These impacts are capitalized via the market risk framework, which under FRTB accounts for losses associated with tail-events via Expected Shortfall (ES) measures, and under sensitivities based approaches reflects price sensitivities to certain risk factors. All of these new measures are designed specifically to counter the Committee’s concerns that market risk capital held through the crisis was in some areas insufficient and a reallocation was necessary. We are seeing not just a reallocation but also a general increase which is material across the sector. Much of this is down to the increased liquidity horizons that the rules under FRTB are looking to capitalize banks for. This is the exact concern that is articulated by the BCBS for the GSIB indicator of STWF.

Basel III introduced an increase in RWAs owing to heightened asset value correlations across large banking groups, or financial sector entities more generally, as this was a trend observed through the crisis. The uplift in RWAs varies between 20% and 30% depending on the PD / LGD / Maturity of the exposure in question; however, it is clear that the sorts of market dislocations arising from similar assets flooding the market and affecting large banks simultaneously, is also already catered for.

Lastly, as markets become less liquid, bid-offers will widen and this will be taken into a bank’s assessment of its prudent valuation adjustments which are often subject to sensitivity analysis, with the net effect being reflected in CET1 capital. Moreover, a significant and sustained deterioration in liquidity of financial instruments could see them move into Level 3 categorisation for which there is already a GSIB measure.

Inclusion of the additional indicator would potentially lead to the unintended consequence, that in a stressed scenario, this would lead to the penalisation of banks receiving deposits where clients are moving their funds in a ‘flight to quality’. Additional capital requirements would reduce the capacity of these banks to accept such deposits, and therefore the buffer these institutions are able to provide in limiting contagion.

**Other Comments**

*Foreign exchange fluctuations*

Foreign exchange rates have little relationship or relevance to actual systemic risk, yet are a substantial driver of changes in the surcharge for GSIBs, which introduces potentially significant fluctuations in surcharge determinations based entirely on an exogenous factor. The volatility is not consistent with Principle 2 of the assessment framework therefore, as data cannot therefore be considered high quality.

As such, we suggest that the methodology should not be calculated based on point-in-time exchange rates, but that it would be more appropriate to use a rolling five-year average exchange rate calculation.
Relative market share

The “Relative market share” denominator is inconsistent with the goal of reducing overall systemic risk because a GSIB does not fully benefit from reducing its systemic footprint if the other GSIBs also reduce their footprint. A firm’s surcharge should reflect any actions taken to reduce its systemic footprint.

The use of relative market share suffers from a further weakness in that it is an aggregation of data from G-SIBs that have different reporting and data quality standards in their home jurisdictions.

As such, an alternative market share methodology should be used, which rewards banks for a reduction in their systemic footprint and avoids the inequities of different jurisdictional standards.

Reporting guidelines

While the Committee has looked at certain aspects of existing requirements and considered new requirements as part of this consultation, we are concerned that insufficient time has been devoted to establishing clearer guidelines that would serve to better promote consistency of application across a range of metrics. Peer analysis, based on publicly available information, shows considerable movements year on year for a number of banks across a range of measures; the different directions imply more than currency moves, and the extent often implies more than changes in strategy or market developments.

The frequency of such movements suggests that many banks are still refining their respective approaches to completing the G-SIB templates; however, particularly for G-SIB scores where there is a strong element of relative measures, greater consistency in application and a level playing field is of paramount importance. Indeed, such a consistent application would give the Committee confidence that the additional capital it requires in the system is appropriately targeted at those firms that are genuinely more systemically important. This would then allow for a better informed and more coherent periodic review of the G-SIB framework, with more robust inputs and metrics able to support better policy outcomes.

Thank you again for the opportunity to provide views on the Consultation Document. We would be pleased to discuss any of these comments in further detail, or to provide any other assistance that would help facilitate your further review and analysis. Please contact Sahir Akbar (sahir.akbar@afme.eu) at GFMA by email should you require any further information.

Sincerely,

Allison Parent
Executive Director
Global Financial Markets Association