September 3, 2018

Secretariat of the Basel Committee on Banking Supervision

Basel Committee on Banking Supervision

Bank for International Settlements

CH-4002 Basel

Switzerland

Re: Basel Committee on Banking Supervision Globally Systemically Important Bank: Revised Assessment Methodology and the Higher Loss Absorbency Requirement (July 2018)

Dear Sirs and Madams,

The Global Financial Markets Association (GFMA)[1] would like to provide additional comments to the Basel Committee on Banking Supervision (the Committee) in response to its recent finalization of revisions to the Globally Systemically Important Bank (G--SIB): Revised Assessment Methodology and the Higher Loss Absorbency (HLA) Requirement ("the Framework"[2]). The Framework's methodology requires G-SIBs to hold higher amounts of loss absorbing capacity to substantially reduce both the probability of default, as well as the impact to the broader financial system in the event of such default. We support the primary objective of the Framework and are encouraged that some of the concerns raised by industry have been recognized, such as: (i) specifying that disclosures required in the revised assessment methodology document must follow Pillar 3 requirements and timelines, rather than the draft proposals in the consultation document requiring either disclosure in the financial statements or a direct link to the completed disclosure; (ii) further guidance on bucket migration; and (iii) publication of an updated operational timetable.

However, we remain concerned that a key issue raised by the industry remains in the revised methodology, namely that the Committee continues to rely on a relative calculation that

[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

[2] https://www.bis.org/bcbs/publ/d445.pdf

provides no recognition for the substantial progress made by international regulators and global financial institutions to increase the safety and soundness of the financial system since the crisis. Additionally, we encourage the Committee to review existing 50 and 100 basis point capital increases between G-SIB "buckets" to reduce cliff effects. We also note that the application of the Framework should not lead to significantly increasing overall capital requirements[3] across the banking sector, consistent with G20 commitments.

GFMA also notes that certain of the issues raised below that our members considered critical to be included in the initial three-year review of the Framework were not raised or considered as part of the consultation on the reassessment. While we appreciate that review of the Framework is a complex task, GFMA believes that regular engagement between the Committee and GSIBs, coupled with transparency around how the Committee identifies which items will be included in future reassessments, would provide a review process that is constructive and more comprehensive. To this end, GFMA would like to highlight opportunities on how the Committee can work with G-SIBs in a more effective manner to gather relevant ongoing input when establishing which areas of the G-SIB Framework requires further review.

GFMA believes its members could be particularly helpful in providing industry input as it relates to (i) the annual run of the assessment which reallocates G-SIBs into different categories of systemic importance based on their score; (ii) recent developments that should be taken into consideration in any future reassessments of the Framework through formal mid-year engagement; and (iii) supporting the Committee as necessary in a holistic review of all post-crisis regulatory requirements, inclusive of the G-SIB surcharge, to ensure all pieces of the enhanced regulatory framework are appropriately calibrated and to ensure the same risk is not capitalized multiple times.

In addition to these recommendations on the transparency and effectiveness of the process of any future reassessments of the Framework, we believe that reconsideration of certain aspects of the framework – despite the recent finalization of the first three-year review – should be undertaken promptly, as set forth below.

[3] We note that the impact assessment of the revisions only notes a "capital increase" when a G-SIB migrates to a higher bucket; however, we believe it essential for the Committee to examine changes to G-SIBs scores within buckets, as G-SIBs maintain substantial management buffers to avoid realizing the significant capital increase (e.g. 50 or 100 basis points) associated with moving to a higher bucket.

1. **Relative Market Share Denominator**: As referenced above, the Committee's Framework measures each G-SIB's systemic indicator score relative to the systemic indicator score of the 75 largest global banking institutions. The relativity of the calculation substantially undermines the incentive and practicability of G-SIBs to improve or control their "measured" systemic profile, and ultimately to engage in effective capital planning. Furthermore, this relative measure of systemic risk results in changes to the score that are unrelated to underlying changes in systemic risk. For example, if all G-SIBs achieve a significant, but equal, reduction in their systemic indicator scores, there will be no change in any firm's G-SIB surcharge, despite the obvious[4][5] decreased systemic risk to the financial system. Using a fixed approach, as the U.S. Federal Reserve Board (FRB) did[6], enables a G-SIB to predict and control its future systemic indicator scores, thereby incentivizing G-SIBs to proactively reduce their systemic footprints, while engaging in significantly more efficient and effective capital planning.

2. **Foreign Exchange (FX) Rate Fluctuations Unrelated to Systemic Risk**: The Committee's G-SIB Framework requires that systemic indicators be converted to euros using a spot rate, exposing non-euro G-SIB scores to significant volatility from changes in FX rates which are unrelated to systemic risk. For example, the 2016 scores of U.S. G-SIBs as calculated under the Committee's methodology increased up to 12%, solely as a result of the appreciation of the U.S. dollar vis-a-vis the euro over the assessment period. In particular, if the euro to U.S. dollar had not changed during 2016, none of the U.S. G-SIBs would have moved to a higher risk bucket under the Committee's methodology. The FRB remedied this issue in their final G-SIB Framework by having U.S. G-SIBs convert their scores using an exchange rate equal to the average daily FX rate over a three-year period, ensuring that market anomalies on any given day are not contributing to substantial swings in G-SIB scores that are unrelated to actual systemic risk. We recommend similar adjustment should be incorporated by the Committee.

3. **Expansion of the Scope of Consolidation to Include Insurance Subsidiaries for Some Systemic Indicators:** Insurance entities are not in the prudential scope of consolidation

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[4] For example, the EBA recently showed that, for a stable sample of 33 EU banks which are used as the "universe" of potentially systemic banks, http://www.eba.europa.eu/risk-analysis-and-data/global-systemically-important-institutions. Such massive decrease does not impact the G-SIB scoring methodology, which should be redesigned to be more risk sensitive.

[5] Survey on the interaction of regulatory instruments: results and analysis (July 2018); Basel III Monitoring Report, (March 2018); and Fourteenth Progress Report on Adoption of the Basel Regulatory Framework (April 2018)

[6] U.S. Federal Reserve, Title 12, Banks and Banking. Chapter II, Part 217, Subpart H - Risk-based Capital Surcharge for Global Systemically Important Bank Holding Companies

for banking groups within the Basel capital framework[7]. The inclusion in the G-SIB Framework is inconsistent with the existing regulatory capital framework reflected. Insurance activity is regulated per se in the major jurisdictions and there is supervision to ensure the risk of insurance activity is captured – in Europe holdings in insurance undertakings are either deducted or risk weighted, in either case, the risk is captured. Additionally, to assess the systemic nature of a banking group owning insurance entities, those groups forming financial conglomerates are subject to the specific EU directive on supervision of financial conglomerates. The prudential framework and supervisory oversight should be addressed at the national level in jurisdictions where there are gaps in oversight. Adding insurance entities within the prudential scope of consolidated banking groups for capital and liquidity purposes may not properly reflect the benefit in cyclical terms. The risks associated with banking and insurance activities counterbalance within a group structure, providing effective diversification, supporting the primary objective of the G-SIB Framework to decrease systemic risk. This easily observable diversification benefit contradicts the approach chosen by the Committee to amalgamate banking and insurance data within each of the systemic criteria. Adding for example securities held by the bank for market making or trading purposes with securities held by the insurance subsidiary as a long-term investment to deliver returns to policy holders does not make any sense from a systemic risk standpoint.

Consequently, as mentioned above, prior to assessing firms under the expanded scope for specific systemic indicators, current risk management and capital requirements for activities related to insurance subsidiaries should be further studied, notably within the Joint Forum[8], which mandate includes to "*address and promote understanding of issues common to the banking, securities and insurance sectors, including the supervision of financial conglomerates*".

4. **Amendments to the Definition of Cross-Jurisdictional Activity:** The components of the cross-jurisdictional indicator should be transparently reassessed in the near-term by the Committee to ensure that the appropriate activity is being captured. The Committee could actively engage with GFMA and its members to ensure that the definition of cross-jurisdictional activity is consistent and rational, and truly reflects cross-border activity. For example, the Committee should consider revising the definition to ensure that local claims are not captured in the cross jurisdictional indicator. GFMA and its members believe that a transaction between parties incorporated in a single jurisdiction, which

[7] "financial activities do not include insurance activities and financial entities do not include insurance entities" bcbs128, page 6, footnote 7
[8] https://www.bis.org/bcbs/jfmandate.htm

stays in that jurisdiction, should not be captured in the cross-jurisdictional indicator. Similarly, when a local subsidiary uses local deposits to lend to local borrowers, in local currency, such business should not be captured in the cross-jurisdictional indicator.

As noted by the Committee, "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." In the case of Europe, a single approach to resolution with the Single Resolution Mechanism, in place since 2015, will enable orderly intra Banking Union resolution. In this regard, we welcome the statement that structural changes in regional arrangements – in particular, the European Banking Union – will be reviewed independently from the three-year review cycle as actual changes are made. The GFMA and its members look forward to engaging with the Committee to ensure the appropriate metrics are captured and the standard is internationally consistent in this regard.

5. **Introduction of a Trading Volume Indicator:** The introduction of the trading volume indicator within the substitutability category is of concern to the industry and seems unnecessary. The trading volume indicatory is unreliable due to its volatile nature, which contravenes 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[9] and criticized for lack of reliability.

   Additionally, the trading volume indicator is intended to capture risk related to a possible disruption to market liquidity that 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.

   To the extent the Committee decides to retain the trading volume indicator, the GFMA looks forward to working with the Committee to discuss the nuances of its inclusion in more detail.

[9] ACPR: Paiements effectués dans l'année de l'exercice, Page 32 - https://acpr.banquefrance.fr/fileadmin/user_upload/acp/publications/analyses-syntheses/201412-AS39-Identification-groupesbancaires-assurances-importance-systemique-mondiale.pdf

6. **Substitutability Indicator:** In addition to the above-mentioned issues, GFMA wants to reiterate the importance of ongoing dialogue between the Committee and G-SIBs as it relates to any future recalibration of the substitutability indicator. As acknowledged by the Committee[10], there is a cap on the substitutability indicator in the G-SIB Framework because "the substitutability category had a greater-than-intended impact on the assessment of systemic importance for certain banks that are dominant in the provision of asset custody, payment systems and underwriting." Although the Committee noted that future "revisions to the methodology may allow [the cap] to be removed at that time," the removal of the cap was proposed by the Committee without any corresponding recalibration that would be a prerequisite to prevent such an outsized impact. Although it was not removed as part of the completed reassessment, we note that the Committee stated that as part of its next review, it will "pay particular attention to alternative methodologies for the substitutability category so as to allow the cap to be removed at that time." We strongly encourage the Committee to work in tandem with GFMA as a review of alternative methodologies are considered, and to conduct a fulsome empirical assessment of any proposed changes to the indicator to ensure the existing out-sized impact to certain G-SIBs is remedied prior to removal of the cap.

Complementing the objectives of the specific points raised above, we believe the Committee should continue to consider recognition within the Framework of a G-SIB's compliance with extensive post-crisis reforms that have substantially decreased the systemic risk of individual G-SIBs and the financial system as a whole.

Discounting the significant progress that has been made in enhancing the safety, soundness and resilience of the global banking sector incorrectly assumes that the impact of a G-SIB's failure would be just as systemically impactful as if post-crisis reforms were never implemented. A firm's compliance with several regulatory enhancements is not reflected in the revised methodology, despite the reduced systemic risk of a compliant firm and financial system as a whole. We urge the Committee to take a pragmatic approach to analyze the overall interactions and degree to which there may be systemic risk in the banking system. Some examples of reforms acting as mitigating factors of systemic risk, finalized or implemented to date, include:

- Total Loss Absorbing Capacity (TLAC) resources;
- Recovery and resolution planning;
- Large exposure limits;
- Liquidity Coverage Ratio (LCR) to address Short-term Wholesale Funding (STWF);

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

- Net Stable Funding Ratio (NSFR) to address STWF and funding stability;
- Capital and liquidity stress testing (CCAR and CLAR1 in the US, SREP in the EU);
- ISDA protocol to prevent runs on derivatives;
- Margin for uncleared swaps; and
- Central clearing for derivatives.

We also note that the G-SIB Framework is being further promulgated in other rulemakings making prompt reassessment of the Framework even more essential. In particular, some of the more impactful rulemakings where the Framework is directly applicable include:

- Leverage ratio: The Committee's finalized minimum standard imposes a leverage ratio buffer of 50% of a G-SIB's surcharge;
- Stress testing: Interaction and overlap with the risks captured in stress testing more generally; and,
- Enhanced prudential standards of regulation and/or supervision associated with being a G-SIB.

As part of the effort to achieve appropriate recalibration of the G-SIB Framework, the GFMA calls on the Financial Stability Board (FSB) to reconvene the Macroeconomic Assessment Group (MAG), which assesses the macroeconomic impact of the Basel III reforms and provided an assessment of the impact of the G-SIB framework in close collaboration with the International Monetary Fund (IMF) in 2011. We highly support the objectives of the Framework for Post-Implementation Evaluation of the Effects of the G20 Financial Regulatory Reforms[11] and believe inclusion of finance ministries, central banks and relevant global organizations, like the IMF and IOSCO, would complement the analysis by the FSB, in cooperation with the Committee, to ensure rules applied do not have unnecessary duplicative macroeconomic impact. The current revised framework references the MAG report released in October 2011, based on data from year-end 2010. As the FSB focuses efforts on coherence and calibration of post-crisis reforms, many that have been finalized and implemented since 2010, the MAG should be called upon to re-assess the macroeconomic impact[12]. This would be consistent with the Committee's stated commitment in the releases of the methodology in 2013 and 2018 that it would capture developments in the banking sector and any progress made when reviewing the Framework. As part of this review, we would recommend that, in order to assess to which extent systemic risks may have partially shifted outside of the banking sector, the universe considered in such study should include the entire financial system,

[11] http://www.fsb.org/wp-content/uploads/Technical-Supplement.pdf
[12] BNP Paribas research update on the MAG study, http://economic-research.bnpparibas.com/Views/DisplayPublication.aspx?type=document&IdPdf=29606

irrespective of the type of financial institutions and the respective market regulations also designed to mitigate systemic risk.

In summary, whilst the GFMA understands the rationale for an HLA requirement for G-SIBs and is generally supportive of the operational timetable as specified, there remain a number of issues which we believe require prompt attention before the next scheduled review of the methodology, due in 2021. Additionally, the G-SIB Framework's incremental macroeconomic impact to growth should be evaluated by taking into consideration the coherence of rules and the appropriate calibration, a step that has yet to be completed. While we continue to be supportive of the objective of the framework, until coherence and calibration is assessed based on the book of work of finalized or implemented under the BCBS capital, liquidity and resolution framework, the incremental capital requirements could prove excessive and duplicative, and undermine other G20 objectives to support incentives for global infrastructure and SME investment, as well as capital markets growth.

Thank you for reviewing our comments. Please feel free to contact Allison Parent, aparent@gfma.org, or Sahir Akbar, sahir.akbar@afme.com, should you desire any additional information.

Sincerely,

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Executive Director

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