International Banking Federation

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Secretariat of the Basel Committee on Banking Supervision
Bank for International Settlements
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Dear Madams and Sirs,

Sent by e-mail to baselcommittee@bis.org

Response to the Basel Committee's Consultation Document Strengthening the resilience of the banking sector (CD 164)

Introduction

The IBFed and its members are supportive of the BCBS overall goal to enhance the quality, consistency and transparency of the industry's regulatory capital base, and to improve liquidity standards globally, as it seeks to further enhance the resilience of the banking industry to absorb shocks from events such as those seen in the 2007-2009 crisis. We support the objectives of improving the quality of the capital base, addressing procyclicality in capital requirements, controlling excessive leverage in the financial system and improving counter party credit risk assessment. However, we are concerned with the potential macroeconomic impacts of the adoption of the Basel Committee's consultative document in its present form and believe that insufficient attention has been given to the potential cumulative impact of these proposals and other regulatory, legislative, and accounting initiatives and the unintended consequences that may result there from

The range and scale of changes now being proposed, which coincides with significant and extensive change that have already occurred within the industry have potentially far reaching consequences for the broader economy. These consequences need to be carefully considered if the right balance is to be struck between prudent regulatory standards and continued economic recovery, so that the financial services industry is able to fulfil its key purposes of facilitating maturity transformation, supporting international trade and providing the critical financial support and working capital to meet the continuing needs of the consumer and corporate sectors.

As the Basel Committee reviews the consultation feedback, assesses the results of the Quantitative Impact Study (QIS) and considers a final package of regulatory revisions, the international financial services industry urges the Basel Committee consider the following concerns and factor these into its final plans:

Key messages for Basel Consultative Paper on Strengthening Resilience in the Banking Sector

Cumulative impact assessment needs to address the impact to the broader economy

As acknowledged by the Basel Committee there is a need to assess the cumulative impact of the proposals as a whole. The QIS, which we fully support, is focussed upon the effect to the banking industry and does not address the effects on the broader economy and the impact the proposed changes would have on the coverage, scope, capacity and price of the financial services that banks provide to corporate and individual clients.

IBFed and its members firmly believe the analysis should not stop at the QIS. At a time when economic recovery is not fully assured it is imperative that a broader review is taken so that the authorities can

understand the potential impacts of their suite of proposals on the global economy and the underlying corporate and consumer base. This analysis must also feed into decisions on re-calibration and the implementation timetable. Premature imposition of higher capital and liquidity requirements on banks will result in lower lending volumes at a higher cost to the real economy with the result that economic growth will be reduced for a while or perhaps permanently stunted. Unintended consequences of the proposals could include an increased cost of capital and borrowing for banks (which will translate into higher borrowing costs for businesses and consumers), a reduction of available credit in the system, and a reduction in investor appetite for bank investments as increased capital requirements drive down rates of return

It is imperative that standards strike the right balance between optimising the regulatory architecture to enhance global financial stability without negatively impacting short and long term economic activity. Measures to reduce systemic risk should not be solely dependent on capital regulation; rather, systemic risk should also be addressed by macro prudential measures designed to maintain financial stability.

Recognition of progress already made

As the Basel Committee evaluates the QIS results, and further develops its recommendations upon the new regulatory proposals, it is very important for the Committee to give due recognition to the actions that have already been implemented by the industry to improve its resilience. This should include not only the changes that have already taken effect (such as recapitalisation of the trading book, aligning investor and sponsor interests in securitisations and to mitigating concentration risk, and improving corporate governance standards, but those that are evolving such as recovery and resolution plans.

It is critical that the Basel Committee take account of these existing changes in order to achieve the right balance that introduces the appropriate range of new regulatory standards while ensuring the ability of the global banking industry to continue its important role in maturity transformation, intermediation, and the provision of credit to businesses and consumers.

Interdependencies and calibration

It is essential for the Basel Committee to recognise the interdependencies between the collective measures outlined in CD 164 and the measures outlined in the liquidity consultative document CD 165, and the full cumulative effect of these proposals. The Basel Committee must determine its priorities and be prepared to delay, amend, or in some cases withdraw recommendations if they are determined not to achieve an optimal balance of prudential regulation and macroeconomic stability or if other initiatives will produce the same results.

It is critical that the Basel Committee engages in an active dialogue with the industry regarding the results of the QIS so that the industry and regulatory community have sufficient time to analyse and discuss the data before decisions are made regarding the structure, calibration and mix of revised regulatory revisions.

Implementation: timing, sequencing and grandfathering

The development of an implementation strategy must consider timing, transition and grandfathering issues.

The transition to new requirements should be properly phased, globally aligned, and timed to minimise disruption of market recovery and optimise the industry's ability to meet credit demand. Due to the significant changes proposed by the Basel Committee, we recommend an appropriate transition period, aligned globally, that allows for the orderly adoption of the new rules. Consequently a phased implementation across a number of years is strongly advised.

Whilst we recognise the political commitment of the G20 to implement the new requirements by the end of 2012 we see this date as the beginning of a journey to final implementation that will need to take a number of years to conclude if economic recovery is not to be permanently damaged.

It will be important to grandfather existing tier 1 instruments and phase in requirements. Relatively long grandfathering periods will be necessary to avoid the 'announcement effect' where the markets factor in higher costs of capital well in advance of the implementation date, thus raising the cost of additional financing, at a time when banks will also be competing with sovereign and corporate entities for funding.

The paper refers to potential grandfathering of tier 1 instruments issued prior to December 17th 2009, the date of issuance of the capital proposal. This sends a strong message to the industry and markets that new forms of economically efficient capital may not be available as tier 1 capital. We strongly urge the Basel Committee to continue to be open to innovative forms of tier 1 capital in order to allow innovation and growth in the capital raising market for banks and to confirm at the earliest opportunity its stance on grandfathering. We believe this to be very important to allow progression of the capital raising market.
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International harmonisation: Level playing field; and avoidance of asymmetry

Unless the final rules are implemented consistently by regulators around the world, the Basel Committee's objective of strengthening resilience of the banking sector will not be effectively achieved. We do not underestimate the difficulties of ensuring this is done. The proposed changes when eventually agreed upon in conjunction with industry must create a level playing field as much as possible, recognising differences across national financial sectors. The Basel Committee should instigate a stringent review process to monitor progress and facilitate consistency.

Market Reaction

The narrowing of the scope of eligible tier 1 capital instruments will have an effect on the diversity of the investor base and appetite of investors given significant reductions in returns on equity. This needs to be carefully borne in mind as the Committee calibrates minimum capital standards. The Committee should also not under-estimate the potential adverse market reaction to any institution perceived not to meet 'published new standards'. Once final recommendations are published the market will view them as the new 'minimum standards' and likely penalise any institutions perceived to be failing these, at a time when financial stability and economic recovery are still fragile. The Basel Committee needs to guard against such negative reaction through clear a statement that the implementation of the revised standards is phased, progressive, and not immediate, and by ensuring sufficient lead times are given. This will be crucial if the end result of achieving the objective of continued sustainability of both the financial services sector and the real economy is to be met.

Pillar 2 standards and consolidated application

The Pillar 2 framework is a more effective and efficient vehicle for addressing banks' leverage ratio and capital conservation buffer. Pillar 2, used effectively, is the most efficient manner in to ensure firms are prepared for stress and downturn scenarios in a manner that is most appropriately tailored to the risks of the specific institution. The Standards Implementation Group to ensure the Pillar 2 supervisory process is applied consistently across the globe at national, consolidated, and college level.

Further consultation

Given the range and scale of the proposed changes, with many component parts still to be finally determined and the QIS results still to be analysed, we consider this current consultation to be only the first stage of the development of policy and an enhanced regulatory regime. This being so we stress the importance to the Basel Committee of ongoing dialogue with the industry as its thinking evolves from this initial consultation. We recommend that a further formal consultation occur once the Basel Committee concludes its deliberations and has evolved its recommend package of revised proposals.

In conclusion, the financial services sector plays a critical role in the real economy. It exists to service the day to day financial needs of consumers and corporates. The role of banks as financial intermediaries is of critical importance to the real economy. Much has been done by the industry to improve the resilience of the sector which has been strongly supported by the industry. Moreover the industry continues to support the G20

mandate to retain Basel II as the regulatory capital standard. However, the next phase of regulatory tools must balance protecting the stability of the financial system with allowing the financial sector and the broader economy to continue to recover. IBFed looks forward to maintaining close dialogue with the Basel Committee as the proposals are refined to obtain the optimum results. Much has already been achieved by the Basel Committee, and in continuing to meet its regulatory commitments the Committee should take sufficient time to consider the right mix, phasing-in and calibration of regulatory tools that will continue to support the global economy.

Yours faithfully

Sally J Scutt

Mrs Sally J Scutt
Managing Director