International Regulatory Strategy Group

DOMINE DIRIGE NOS
CITY OF LONDON

Telephone 020 7332 1054
Fax 020 7332 3326
Email:
audrey.nelson@cityoflondon.gov.uk

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

Date 12 May 2010

Dear Stefan,

Basel Committee on Banking Supervision Consultative Proposals to Strengthen Global Capital and Liquidity Regulations

The International Regulatory Strategy Group (IRSG), representing a cross-section of UK financial services, would like to submit the following comments on Strengthening Global Capital and Liquidity Requirements. The IRSG is a practitioner-led body comprising leading UK-based figures from the financial and professional services industry. It aims to shape the international regulatory regime, at global, regional, and national level, so that it promotes open, competitive and fair capital markets globally that support sustainable economic growth. Its role includes identifying strategic level issues where a cross sectoral position can add value to the existing industry views. It is an advisory body both to the City of London Corporation, and to TheCityUK, a new independent practitioner-led body which is being established to coordinate the promotion of the UK-based financial services industry.

An independent research report produced by Europe Economics entitled 'Comments on the Future of Banking Regulation' has been sent separately to you as a further contribution to the current debate which represents Europe Economics independent view of the regulatory reform suggestions. The report does not represent an agreed industry or City position.

The purpose of this note is to complement the detailed submissions from individual financial services firms and trade associations, by highlighting the more macro or strategic issues. We look forward to continuing our discussions with you in Basel as this important work progresses.

The IRSG commends the approach by the Basel Committee to develop a robust but flexible regulatory framework to support global economic recovery. Capital and Liquidity reforms have a key role to play in improving the management of systemic risk, provided the measures are implemented internationally in a consistent manner, as proposed by the G20. In commenting below the IRSG notes that the financial services industry supports the Basel initiative and the steps already taken by industry to improve risk management and withstand market turbulence. The IRSG commends the Basel Committee's commitment to consultation with the industry, and would

support proposals for the publication of an action plan for implementation to foster a consistent international response.

One overarching issue of considerable concern is the timing and sequencing of the implementation of the proposed measures. It is essential that the impact on economic activity is assessed before implementation of the new measures. If financial firms were unable to raise additional capital they would be forced to shrink their balance sheets further and thus be unable to provide the necessary level of credit to the wider economy. Therefore the introduction of significant capital increases whilst economic recovery remains fragile might result in a double dip recession, which could itself then cause renewed instability in the financial sector.

Many financial groups now operate on a global basis and not least for prudential reasons they should be subject to a harmonised capital and liquidity regime. An internationally agreed implementation timetable would not only ensure a level playing field, but improve the prospects for compliance. A fragmented approach, in implementation and timing, would undermine the ability of colleges of supervisors to act effectively, based on a shared assessment of the risks. A harmonised approach would also of course support a more level international playing field and avoid regulatory arbitrage. We therefore argue that all Basel Committee members should agree to full implementation of the new framework and at the same time.

Therefore we suggest that the objective for this year should be agreeing an international plan, in line with the G20 commitments, with the final details and calibration following over a longer time frame. Whilst recognising the political pressure to deliver quick implementation we think that a longer time horizon than 2012 should be adopted. This would allow additional consultation and assessment of the likely impact on economic growth of the proposals, and as necessary the recasting of proposals that are judged with additional study to fail to deliver their agree goals. We are concerned that over hasty implementation, particularly if internationally fragmented, could have damaging unforeseen consequences, triggering a new crisis. We therefore fully support the broader impact assessment that is being undertaken by the Basel Committee with the Financial Stability Board.

We finally wish to comment on two more technical issues, leverage and procyclicality.

Everyone agrees that excessive leverage was one of the drivers of the financial crisis and that therefore some form of regulatory intervention is justified. However, delivering a leverage ratio that is effective without unfairly disadvantaging different legitimate business models is fraught with problems and would create an unlevel playing field. A simplistic methodology that does not take into account credit risk mitigation and the risk profile of a firm would not only distort competition but would also undermine incentives to manage risk better, which must be counter

prudential. We would therefore argue that the approach to leverage must take into account differing business models and should therefore be applied under Pillar II, allowing supervisors flexibility in its application, recognising business model specifics.

Whilst we support the concept of countercyclical capital measures in principle there are concerns that the full impact of the various proposals in aggregate is not being sufficiently taken into account. If too much capital is required to be held by firms during periods of economic growth then economic growth itself could be harmed. Moreover, it might prove difficult to judge at what stage of an economic downturn these capital buffers should be allowed to be run down, and whether this should be decided at an international, regional or national level. We would note that under the current Basel framework regulators already have power to require capital conservation under Pillar II, and many have used these powers. The consistent application of these powers, in particular if aligned with new macro prudential supervisory tools, rather than the development of additional approaches is a more prudent line to adopt and could lead to a more harmonised approach internationally.

The IRSG hopes that these comments will assist the Basel Committee in reaching conclusions which will improve industry resilience whilst encouraging economic recovery at a time when the prospects are at best uncertain. The IRSG looks forward to continuing the dialogue with the Basel Committee on this and other important issues affecting the financial and professional services industry in the future.

André-François Villeneuve

Stuart Fraser

Andre Villeneuve
Chairman IRSG

Stuart Fraser
Deputy Chairman IRSG and
Policy Chairman
City of London Corporation