Response to the BCBS Consultative Paper 201

Globally Systemically Important Banks: Assessment Methodology and the Additional Loss Absorbency Requirement

Executive Summary

The BCBS consultative document is seeking stakeholders' comments on the methodology it has elaborated to determine the additional loss absorbency capacity to be created, and the associated instruments to be issued, by banks deemed to be "too systemic to fail".

We believe the consultation deserves more than technical comments, developed in our detailed response, and should be answered in the wider context of banking reform. It is true that some banks did not behave soundly. The Basel III Accord corrects the shortcomings of the previous regulation and rightly addresses these erring ways. However, the cumulative approach adopted by the Authorities does not help in understanding the appropriateness and efficiency of the various measures adopted; this is particularly the case for the capital surcharge, the magnitude and modulation of which is the object of the Consultation Paper. The global impact of these requirements on the economy is rather uncertain, to say the least, and most certainly not timely, particularly for Europe. The focus on capital requirements is excessive when many stakeholders, including some supervisors, are convinced that adequate governance and risk management, combined with effective supervision and supplemented with resolution capacities would be much more efficient and less hazardous in their impact.

Good regulation must be convincing, credible and transparent;

The capital surcharge imposed on some designated banks fails to fully meet these criteria.

Its justification is far from being **convincing** as the very existence of the negative externalities of large institutions that it claims to compensate is highly questionable. The current banking system is interconnected by essence mainly through financial markets. This is all the more true the lower the intermediation role of banks. The size of banks is clearly not an indicator of any propensity to contagion. Actually no one knows when a bank becomes systemic; the recent crisis showed it. We still believe that large and universal banks have the capacity to reduce the influence of markets, increase risk management capabilities and to absorb losses through diversification. Markets as well as supervisors recognize these factors of resilience through the acceptance of lower solvency ratio than the one expected from small or specialized institutions. Penalising them on the basis of such a dramatic change of paradigm cannot but be questionable.

The methodology determining the magnitude and distribution of the capital surcharge is not entirely **credible**.

1. First of all, the level of the surcharge is grossly overestimated. Positive externalities are largely ignored; the capital definition streamlining decided by the Basel III Accord has not been taken into account; on comparable calculation grounds, the capital surcharge would have been roughly divided by three!
2. Secondly, the allocation criteria are mainly an expression of size whereas we know that this indicator is either "ill – grounded" or already rigorously taken into account by the new regulatory framework through RWAs and leverage ratio. Retaining this factor once again clearly calls the Basel III Accord into question and leads towards growing disintermediation, which, in itself, increases interconnectedness and hence threatens stability. Diversified and cross-border activities are the only new factors that may be viewed as supporting the capital surcharge, whereas these characteristics were considered to date as the bases of sound banking! They now appear in the eyes of some regulation bodies as expression of complexity and weakness. This dramatic change in the risk management paradigm is amazing and not seriously explained. There are still different economic cycles across countries and across businesses. In point of fact, diversification is a better protection against failure than additional capital.
3. Finally, the data used, which are admittedly not reliable or complete in their current form, will have to become truly accurate and consistent despite the divergences we still observe in accounting standards. The review process will also need to be more frequent and expeditious.

Despite the statements made in the document, the contemplated methodology cannot be qualified as **transparent**. The selection of the "systemic banks" constituting the sample is not spelt out and surprisingly does not cover all the banking

systems of the G20 countries. The range and number of buckets used to adjust the surcharge to so called bank's systemic profile do not appear to have scientific grounds and cannot be easily reconstructed. Banks and more generally the investor community cannot determine from the Consultation Paper how an individual institution's score is calculated and how it could be affected by the firm's behaviour. Designing and adopting a regulation distinguishing 28 banks in 4 buckets out of an undefined sample of 73 banks, without a clear updating pattern, will be, in this context, a formidable, if not insurmountable, legal challenge!

It should not harm the economy, particularly when the latter is fragile and dependent on the banking system as in Europe;

Banking regulation may be demanding but it should not hamper the banks' capacity to finance the economy and foster growth. The Basel III Accord is already giving rise to a lot of concerns in that respect. Implementing an additional capital burden amplifies these worries. Moreover, restricting it to some banks on the bases of their size and international reach is introducing unjustifiable distortions into markets where all institutions, whatever their characteristics, are currently competing on equal terms.

This argument is particularly valid for Europe as intermediating and cross border banks are particularly hurt by the new regime. Giving the same status to financial transactions between Member States as with any other third countries is clearly contrary to the treaty of Rome, the founding act of the Union. The cross-jurisdictional activity criteria must be set aside or at least adapted to political realities.

The European economy is currently very fragile and dependent on the banks' ability to support it. It would be incomprehensible to penalise the development of the European banking market in these circumstances while convergent regulation and supervision are being set up with the creation of the EBA and the elaboration of a unique set of Recovery & Resolution rules.

All in all, the playing field should absolutely be kept level, within countries, within Europe and obviously throughout the world, including the USA. The capital surcharge challenges this basic feature of our current open economy and further reduces the capacity of intermediating banks to fuel the economy where it is the most needed.

Governance, Supervision practices and Resolution tools are much more critical for the stability of the financial system than excessive capital;

Capital does not help reducing systemic factors nor even truly protect against failure. Is there anyone who seriously believes that the crisis in bank perceptions that we are currently experiencing because of sovereign indebtedness would be less worrying had large banks been more heavily capitalised? In reality, the last crisis showed that tax payer's money had to be used mostly because of **inadequate governance and risk management**, **poor supervision** and **lack of resolution tools**.

The first line of defence is clearly the banks' capacity to ensure good management, which means entrepreneurship, risk awareness and control. Such a balanced approach cannot successfully exist without adequate governance of financial institutions. The Basel Committee has already worked on this issue and elaborated sound principles. They could be usefully publicised and strictly enforced.

Good supervision practices are critical. However, little attention seems to have been paid to this issue. More should be done to enhance the expertise and coordination capacity of supervisory bodies. Some supervisory bodies also need more powers in order to truly influence the behaviour of harmful firms.

Tools would also be welcome to efficiently resolve multi-faceted activities, particularly when they are combined with an international dimension. This issue is precisely the one to be tackled by the international resolution framework that the FSB intents to develop.

A capital surcharge thus appears as the least significant measure to implement; it should only be contemplated as a substitutive sanction and absolutely not as a cumulative requirement.

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Our detailed comments show the weaknesses and shortcomings of the proposed methodology. The additional capital surcharge hardly fits in the Basel Committee regulatory approach and appears to be too questionable to serve as an unchallenged and legitimate definitive regulation. Its impact, when accumulated with the stringent reform that is underway, is unknown or is to be seen as an additional depressive factor in an already recessive economy. It is also clearly redundant with the announced "Recovery & Resolution Plan" regulation. Elementary wisdom would dictate delaying it for review once all the other highly demanding regulatory measures have been implemented and their efficiency assessed.

The more the Authorities appear to penalise banks, including those that have not experienced difficulties, the more they weaken the confidence in the financial system that is essential for the smooth functioning of the economy. The present financial turmoil should be a warning signal in that respect.

BNP Paribas Detailed Response to the BCBS proposal

"Global systemically important banks:
Assessment methodology and the additional loss absorbency requirement"
July 2011

I - Introduction

§1 to §10

1. The BCBS approach focuses outrageously on the (relative) size of banking institutions, and fails to take into consideration different factors that could be described as positive externalities which arise from the dimension of the activities of a banking group.

It seems useful to note in this respect the contribution of major banking institutions to the economic growth and resiliency of the financial system. In addition to the diversification of the risks related to the structure of their assets and their income sources (geographic diversification of their businesses and their portfolios), these institutions have contributed in a recent period to the effective resolution of the defaults of institutions in distress.

To ignore in particular the link between risks diversification and the size of activities would lead to the emergence of less diversified institutions, which is not necessarily synonymous with less systemic risk. A break-up of the major banking groups could in effect reintroduce at national levels systemic problems that do not exist today (because of the increase in the level of correlations between smaller but imitating institutions) and shift major risks to shadow banking.

2. The framework proposed by the BCBS, if it were implemented as it stands, would create competitive distortions among banking institutions first, and between banking and non-banking institutions second. Therefore, it is crucial that, in addition to the 73 banks selected a priori in the framework of the mechanism proposed, all monetary and non-monetary financial institutions be involved.

Above and beyond the extension of the scope covered, the articulation between global, regional and national levels, even by type of activity, should be studied in depth to avoid creating new competitive distortions.

In closing, it is important to note that the system proposed does not guarantee consistency with other regulatory mechanisms implemented elsewhere (cf. Dodd Frank, for example) and that a number of accounting harmonisation issues still have to be addressed; this point is particularly important since the system proposed claims to be purely quantitative.

3. The current stacking of reforms makes significant measures impossible today, both because of the historical and dated nature of the data available, and also because the other regulatory changes (including Basel III) will induce changes in the business model of the institutions in question, which could call into question certain points of the process proposed. Therefore, it seems premature to construct a quantitative mechanism on a subject this new in the currently, rapidly changing regulatory context.

II - Assessment methodology for systemic importance of G-SIBs

General comments

§11 to §13

4. The amount of the additional loss absorbency capital of an institution considered to be potentially systemic is a function of two parameters: its systemic score (determined mechanically by the interplay of different indicators) and the scale which gives the amount of the additional loss absorbency capital as a function of the systemic score. Yet, these two indicators have been calibrated independently of each other.

The approach is debatable and it is based on a set of conventions that is difficult to question because of the insufficient information which has circulated on the justification of those conventions. If, in the future, it turns out that certain institutions are led to challenge the application of these principles, for one reason or other, this lack of tangible elements could lead to questions about the credibility of the regulatory system.

This point is even more important because the approach is designed to be purely quantitative. The possibility of a qualitative assessment is discussed,[1] but its exceptional and conservative nature is immediately stressed. This quantitative bias may subsequently prove to be extremely dangerous, particularly because the methodology is not yet assured (the method for calculating the final score can be criticised and the additional loss absorbency amount is questionable – see below), and also because academic discussions on the issue are just beginning. All these factors argue for more extensive studies before any decision is made.

[1] - §13: "[…] the quantitative indicator-based approach can be supplemented with qualitative information that is incorporated through a framework for supervisory judgement. The supervisory judgement process, however, is only meant to override the results of the indicator-based measurement approach in exceptional, egregious cases and is subject to international peer review to ensure consistency in its application."

Indicator based measurement approach
§14 to §51

5. The assessment of the more or less systemic nature of an institution is relative (in other words, an institution is simply more, or less, systemic than the 72 other institutions considered a priori as potentially systemic. This is only a question of rank). This assessment therefore does not convey the correct incentive system for the institutions identified as G-SIBs. In effect, the relative nature of this assessment (relative to changes in the other institutions) does not guarantee to an institution that it can direct its actions over time in a way that would control its systemic importance.

The key point is that the magnitude of the systemic risk of all the institutions concerned is not taken into consideration in the analysis (which, in a favourable hypothetical case, would allow all the G-SIBs to see a reduction in their capital requirements).

6. The choice and the method for calculating the different indicators and the final score can be criticised at more than one level. The following paragraphs present a set of recommendations which is only intended to correct the main inconsistencies in the calculation proposed.

A - Cross-jurisdictional activity
§18 to §26

A1. **Cross-border activities in Europe**. In terms of interconnectedness and cross-border activities, the European Union must be considered as an economically integrated zone. This is all the more true that the European institutions are currently developing a common framework for banking resolution at the EU level, which would make the European situation comparable to other countries (such as the USA where bankruptcy law is dealt with at state level but under the umbrella of a federal resolution system). There is, therefore, no reason to limit the definition of "domestic activities" to one member state, especially when banks have several domestic markets in Europe, and to make a distinction between the assets of the banking institutions in the different countries of the European Union. In the calculation of the score, the assets in question should be considered as belonging to the same jurisdiction or, at least, should be weighted (by assigning a null weighting to the countries of the euro zone).

A2. **Redundancy of the indicators**. The indicators, as they are proposed, are partially redundant notably with the indicators used to measure the size, the substitutability, the so-called complexity and the so-called interconnectedness. We will also note that these two categories of indicators ("cross-jurisdictional activity" and "complexity") have this in common—they were added by the BCBS to the three categories of indicators referred to in the IMF/BIS/FSB report submitted to the G20 in October 2009. These indicators have a common objective to take into account the potential difficulties of a "resolution" process.
To avoid any redundancy, it would be appropriate to deduct from the indicators of "cross-jurisdictional activity" not only OTC derivatives (which is the case in the proposal), but also all the assets also included in the complexity indicators (Trading Book and/or AFS).

B - Size
§27 to §28

B1. **Overweighting of the "size" criterion.** The criterion of size is probably the most problematic on the list of the criteria used by the BCBS. In addition to the comments presented above, it is important to stress that this indicator is highly correlated with the other indicators used to measure the systemic importance of an institution, including in particular the indicators of substitutability[2]. As a result, in addition to the methodological questions raised by this point (score based on correlated "explanatory" variables), we can only note the implicit over-weighting of this effect in the final result, which goes well beyond the 20% stated. This raises the question of maintaining this variable in the calculation of the score, since it is already taken into account elsewhere.

B2. **Redundancy of the indicators**. As for the preceding indicators, in order to avoid double counting with the complexity indicators, it would be appropriate to deduct from the total exposures those which correspond to the Trading Book and to the AFS, which are already included in the calculation of the complexity indicator.

[2] - It is noted in passing (§53) that the selection of the 73 banks on which the statistical analysis was performed, and on which the calculation of the scores for the different indicators was based, was performed by the BCBS by applying a size criterion and a qualitative judgment to the largest global banks, which again highlights the highly questionable bias of the approach in favour of the "size" effect.

C - Interconnectedness

§29 to §34

C1. All interconnectedness metrics should be derived from economic metrics rather than accounting-derived metrics, notably to avoid distortion between different GAAP (ex: US GAAP vs IFRS)

C2. **Degree of regulation of counterparties.** In order to recognize the importance of the regulations established, and also to favour transactions between regulated entities (to the detriment of shadow banking), the indicators in this category should take into consideration the more or less regulated status of the counterparties of the institution in question. To do this, the indicators used should be weighted as a function of the level of the regulation that is applied to the entities in question: the most regulated institutions, for example those that are subject to the Basel III regulatory system, should be assigned a very low weighting, etc.

C3. **Degree of dispersion of the counterparties.** A measurement of the dispersion of the commitments among institutions should be introduced in favour of institutions whose transactions are executed with a large number of counterparties rather than concentrated on a few counterparts.

C4. **Taking netting into consideration.** The netting process used in the calculation of the two indicators (intra-financial system assets and intra-financial system liabilities) should be consistent with the contractual clauses of the netting agreements in place, which would lead to:

- netting the collateral values of the loans and the collateralized borrowings, including secured debt (in the suggested metrics the two values appear as gross);

- considering a net exposure per counterparty of all the transactions covered by a netting agreement, including the transactions which may be assets and liabilities (for example: derivative products, repos/reverse repos).

C5. **Wholesale funding ratio.** Insofar as the banking institutions will soon be subject to two liquidity ratios (LCR as of 2015 and NSFR as of 2018), it seems non appropriate to re-introduce this dimension in the calculation of the systemic score in the form of a third ratio (wholesale funding ratio). Actually, the suggested ratio is completely at odds with the aim it is given (cf. Appendix)

D - Substitutability

§35 to §42

D1. **Custody and syndication.** It is important to remember that assets under custody are segregated and therefore they are not exposed to the default of the custodian bank. Moreover, clients do not concentrate all their assets in a single institution. If there is a problem in the institution responsible for the securities, since the market is competitive and the assets are segregated, a transfer to other institutions would be done relatively easily.

In the same way, it is hard to see why the activities of syndication and securities custody are used as indicators of systemic risk. Thus, it is not certain that a reduction in syndication activities (which contribute to the pooling of credit risk) is synonymous with a reduction in systemic risk.

D2. A banking institution temporarily unable to fulfil a service can generate disruptions, which generate economic costs, but that does not imply that this is necessarily a systemic risk.

E - Complexity

§43 to §51

E1. **Redundancy of the indicators.** Though the announced objective is to capture business, structural and operational complexity, the Complexity indicators (OTC derivatives gross notional value, Total value of level 3 assets and total value of securities holding in trading book and AFS categories) are in fact mostly driven by size, reinforcing the double-counting with the previous indicators as stated in section A.

E2. **Choice of the indicator for OTC derivatives.** An increasingly large number of OTC derivatives transactions are cleared through clearing houses. So it is difficult to say in what way the "OTC derivatives notional value" indicator of an institution could evolve in the near future. This leads to questions about the future relevance of such an indicator and an anticipation of the revision of its weighting.

Bucketing approach

§52 to §55

7. No specific justification is given to this division into capital buckets by score bracket except a reference to statistical analyses that are not communicated[3]. We cannot but be uncomfortable with such an arbitrary approach. The determination of the bucket thresholds is a particularly sensitive issue that requires full transparency.

Supervisory judgment

§56 to §67

8. The overall G-SIB model proposed is "competitively" unfair. The purely quantitative nature of this model does not allow taking into account, in the final grade, qualitative aspects that may have a nuanced effect on the outcome.

For example, the RRP (Recovery and Resolution Plans) recognized as credible by the "home" regulator (and which rightly aim to organize the rescue process in the event of a crisis to reduce the economic impact) are not taken into account, nor are the quality of the models used for risk management by the institutions concerned.

A certain degree of independence should thus be given to the "home" regulator to allow it to adjust for certain distortions[4].

9. The model proposed only makes sense at the consolidated level: it is particularly important that a clear process be established for allocating systemic "global" and "local" surcharges to avoid having banking institutions that are considered to be G-SIBs, and whose subsidiaries would be considered locally as (local) SIBs, allocated a double capital surcharge. The "home" regulator's role must therefore also be strengthened to avoid a drift toward "host" regulators who may call into question the coherence of the overall model.

Periodic review and refinement

§68 to §72

10. The capital surcharge for an institution depends on:

- the amount of each of the 12 individual indicators (= the numerator of the score of each indicator);

- the aggregated amount for all of the 73 banks of each of the 12 individual indicators (= the denominator of the score of each indicator shared by all the banks in the sample group);

- the weighting given to each score of the indicator in its indicator category;

- the threshold levels for the total score (= systemic score of an institution) defining the capital buckets.

Although the BCBS (§69) document specifies the frequency of the review of the numerators (annual), weighting (3 to 5 years), and threshold levels for bank scores (3 to 5 years), it says nothing on the frequency of the review of the denominators of the indicator scores. This is a serious matter. If the denominators are reviewed annually (i.e. consistent with that of the numerators, the denominator of an indicator being the sum of the numerators of the various banks in the sample for this indicator), there is a serious risk that the indicators will evolve in a way that could be counterintuitive for an institution (cf. 6. above); on the other hand, if the revision frequency of the denominators is modelled on that of the threshold of scores defining each bucket of capital (i.e. every 3 to 5 years), the aforementioned effect would temporarily disappear only to recur periodically with the risk of a jump in the value of the indicators, and hence of the score.

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[3] - §55: "[…] In addition, thresholds for the buckets should broadly correspond to the gaps identified by a cluster analysis of the scores produced by the methodology."

[4] - The use of a qualitative assessment is mentioned in the text, but only in a very limited framework and tending in the direction of an increase in the loss absorbency of the capital.

If the review process is too long or not regular, there is a high probability that banks will be subject to higher capital charges that what they would be subject to according to their current situation – notwithstanding the fact that the indicators will already be built on data from the previous year (or even the year before). In that regard, it is crucial to recall that the situation of one bank may drastically vary from one year to another. To take an example outside of BNPP, the balance sheet of a large non-European investment bank may increase by 34% or decrease by 21% year to year.

nov-05	nov-06	nov-07	nov-08	déc-09	déc-10
706 804	838 201	1 119 796	884 547	848 942	911 332
Var YOY	19%	34%	-21%	-4%	7%

In other words, if the numerators are reviewed annually it is also crucial that the denominators and buckets are adapted with the same frequency.

Clarification on the issue of this calculation is imperative.

III - The magnitude of additional loss absorbency and its impact

§73 to §79

11. The theoretical justification for the amount of 3.50% (maximum loss absorbency) is not convincing and seems even to be flawed. Once the calculation is rectified, the order of magnitude of the maximum loss absorbency is 1%.

A maximum loss absorbency of 3.50%, or even 2.50%, is thus significantly higher than the acceptable limits with regard to the macroeconomic analysis carried out by the LEI experts.

In-depth commentary:

This error arises from the transposition factor used by the BCBS to transition from the world of Basel II (historic data) to the world of Basel III (calculation of the ratio). This factor corresponds to the increase in RWAs noted in the QIS (published by BCBS in December 2010). This having been said, it ignores the impact of regulatory deductions on the new solvency ratios[5]. The (necessary) taking into account of these additional deductions leads to a conversion factor of the Basel II TCE toward the Basel III *net CET1* of 0.6246 (=(1-0.2317)/1.23) and not 0.8013 (=1/1.23)[6]. It therefore results in a maximum net CET1/RWA ratio of 8.12% (compared with 10.57%), which implies a maximum loss absorbency of 1.12% (and not 3.5%) of the RWA.

The foregoing analysis depends on the QIS results of the BCBS pertaining to the 87 banks in Group 1, a larger bank sample than the population of G-SIBs used by the BCBS (27 banks). But the QIS reveals a “size of institutions” effect, which plays favourably on the variation in the RWAs and on the proportion of regulatory deductions inherent in the transition to Basel III[7]. One may therefore reasonably suppose that the relevant divider for transition from the TCE/RWA solvency ratio of Basel II to the net CET1 /RWA ratio of Basel III is actually higher (higher numerator, lower denominator) for the G-SIBs than for all the banks in Group 1. Therefore, the maximum ratio and the maximum loss absorbency reasonably applicable to the G-SIBs are in fact slightly lower than the levels cited above (ratio of 8.12% and loss absorbency of 1.12%).

IV - Instruments to meet the additional loss absorbency requirement

§80 to §89

[5] - According to the QIS of the BCBS, the Basel III regulatory deductions totaled, at the end of 2009 and for the 87 banks in Group 1, 41.3% of the common equity, of which 23.6% represented goodwill and other intangibles, already deducted from the TCE in the LEI’s work, and 17.7% represented non-deducted items (cf. Table 5, page 12 of the QIS of December 2010 (BCBS 186)).

Items not yet deducted thus totaled on average 23.17% (=0.177/(1-0.236)) of the TCE in the meaning of the LEI (i.e. gross CET1-goodwill-intangibles).

[6] - These results present an approximation of the measurement where the sample of banks covered by the calculation of the deductions (87 banks) differs slightly from that of the banks that provided sufficient information to enable the calculation of the RWAs (74 banks).

[7] - Thus, the increase in the RWAs was +23% for the large banks in Group 1 compared with only +4% for the other banks (Group 2). Similarly, the regulatory deductions (beyond *goodwill* and *intangibles)* totaled 17.7% of the CET1 (23.2% of the Basel II TCE) for the first group and only 13.0% (respectively 14.7%) for the second.

The FSB conclusion is not based on a thorough analysis of the possible alternatives but we do also admit that their credentials are not overwhelmingly convincing.

V - Interaction with other elements of the Basel III framework

§90 to §95

13. The loss absorbency capital for systemic risk is founded on the principles of Pillar 2. The "home" regulator therefore has to be careful not to double count the effects when setting the level of the loss absorbency capital under Pillar 2.

VI - Phase-in arrangements

§96 and §97

14. Considering the probable interactions among all the measures impacting the SIFIs, it would be wise to make sure that the schedule for implementing the "G-SIB" model is in line time wise with other regulatory models affecting the SIFIs and that it is consistent with the initial objectives and priorities of the G20.

15. It is certain that the market will not wait for the deadlines set by the regulator to require implementation of the adopted model by G-SIBs. Therefore, the still incomplete nature of the latter presents a risk (in the event of a major development) for the future. If the final decision on what to do is made after January 1, 2014[8], as is mentioned in the text, then it would be reasonable to postpone any decision to the end of 2013 and avoid any effect of an announcement between now and that time, while using the two coming years to give further consideration to the model to be implemented.

[8] - The model is expected to be phased-in between January 1, 2016 and December 31, 2018.

Appendix

I. Introduction
§1 to §13

Beyond the particular points evoked below, one can wonder about the real target of the regulator when adopting such an approach which doesn't take into account scale effects and internal risks diversification in large banking groups.

Is the regulator's objective to push large banks to break down their activities, their portfolios, their processes and also their functions, on a country basis? That would lead to groups organized with myriads of operational subsidiaries, without link between them. In such a picture cross-selling would be limited, a counter-cyclical management in a country which would be based on the good health of another would be unthinkable, and so on… but the systemic importance of such a bank would decrease significantly.

One can wonder about the systemic risk of national banking systems made so granular. One could argue that the systemic risk induced by large international banks would be replaced by a systemic risk resulting from the rise of the level of the correlations between the assets of the banks become local which, subject to identical regulatory requirements, would mechanically adopt a similarity of behaviours (endogenous with the regulation). With, in parallel, a loss of economic efficiency (scale effects within large groups, propagation of best-practices from one country to another, etc.) and, most probably, a transfer of large corporate international needs to the shadow banking area.

It is probably worth reminding that establishing additional requirements for large international firms such as living wills and resolution plans will help regulators in reducing systemic risk much more than any discriminatory capital surcharge.

A far more useful method in our sense to assess systemic risk at global level would be to use the same methods as used by risk management divisions to assess the risks of one firm and aggregate it internationally. Though we reckon the risk aggregation issue is complex at the global financial system level, we think that could prove more useful than any arbitrary list of banks. We therefore urge the Committee to engage an open dialogue with the Industry on these important and challenging issues and we wish to support the Committee as fully as possible.

II. Assessment methodology

A – Indicator-based measurement approach
§14 to §51

1. Cross- jurisdictional activity
§ 18 to §26

The BCBS suggests basing the measurement of "cross jurisdictional" activity on reports prepared by banks for the Bank for International Settlements (BIS).

These reports are organised differently depending on whether they cover assets or liabilities.

Reporting pertaining to assets

Features

- Quarterly reporting
- Consolidated basis
- Accounting source until the end of 2011, risk reporting source beginning in 2012
- The BCBS refers to BIS statements that are not directly prepared by the Banks. The Banks provide reports to the ACP (International consolidated loans) and the ACP uses these reports to fill out the BIS templates.
- Reports currently being overhauled: reporting on international consolidated loans will be combined with reports on international commitments. As a result, there will be a division by classification of Basel reporting of items (SOV/CORP/INST/RETAIL) overlapping with geographic regions.

Procedures

Reporting procedures are established by instructions that are referred to in the SIFIs consultations with the BCBS.

The valuations used are as follows:

Valuation	BIS Instructions	Applicable until March 31, 2011	Applicable since March 31, 2011 at the request of ACP	Beginning December 31, 2011
Scope	Not specified	Accounting	Prudential	Prudential
Reverse Repos	Not specified	Face value	Face value	Book value with application of Basel netting (=Leverage ratio?)
AFS securities	Book value	Face value	Revalued value including items to be amortised in the TIE	Non-revalued value but with items to be amortized in the TIE and associated loans (=COREP measurement)
Trading securities	Fair value	Fair value	Fair value	Fair value
Adjustment accounts	Not specified	Face value	Excluded	Excluded
Loans and advances	Book or face value	Face value	Book value including items to be amortized in the TIE and associated loans	Book value including items to be amortized in the TIE and associated loans (=COREP measurement)

Derivatives are excluded from the items serving as a basis for the SIFI calculation. They are in the reports submitted to the ACP for the Basel “NET PV” (without add-on), but in entries that are not included in the consultation.
The rules for geographic breakdown correspond to the following criteria:

	Domestic claims in the reporting country		Cross-border	Local claim in local currency	Local claim in foreign currency
Claim booking	France	All	France	Out of France	Out of France
Customer	French	All	not French	not French	not French
Guarantor	French	French (HO home for Bank's Branches)	not French	Resident of host country	Resident of host country
Currency	All	All	All	Host country	Diff. Than host country

The scope of the declaration includes Cross-border and local claims categories, all currencies.
Thus, a loan made by BNL in euros to an Italian client (and/or with an Italian guarantor) will be included within the scope of this report.

Noteworthy points

The inclusion or exclusion of intra-group transactions is not clearly defined in the consultation. Paragraph 20 specifies the exclusion of intra-office claims, but the BIS instructions for creating the underlying statements do indeed specify the exclusion of all inter-office transactions.
This point should be specified to confirm the exclusion of all intercompany transactions.

Reporting pertaining to liabilities

The BCBS consultation requests data on liabilities by geographic zone, coming from the combining of various existing reports for the BIS, either on a consolidated or company alone basis.
Analysis of these reporting statements must still be carried out, particularly to measure the relevance of the values used for the same entries between assets and liabilities.

2. Size
§27 to §28

In determining the systemic importance of banks, the attention largely focused on size seems totally overestimated. Size should not be considered as a proxy of systemic importance. First of all, what matters in terms of banks size is the level of risk of their balance sheet and the size of their print on the different markets where they operate., which is an expression of their use for the economy and therefore should also be considered as positive externalities.

1 – The BCBS consultation itself seems to consider that size means excessive print. Indeed, is stated that “the larger the bank the more difficult it is for its activities to be quickly replaced by other banks and therefore a greater chance that its distress or failure would cause disruption to the financial markets in which it operates.” A smaller bank with a higher print on a given market being harder to replace than a larger bank with a smaller print in such a market, this proves that **the key element of systemic importance assessment should be the evaluation of excessive print on a given market**. It should be noted that such a cause of systemic risk is currently reined in by supervisors and by the competition authorities (that have and used the power to veto mergers that would have led to excessive positioning).

2 - A risk, either idiosyncratic or macro-economic, is deemed systemic if there is a danger of contagion within the financial sector or even beyond, to the economy. This is exactly why the positive impact of large banks on financial stability must be acknowledged. Their geographic and business diversification reduces their vulnerability and hence reduces systemic risk, that is to say the danger that a given risk makes them contaminate the financial sector or the economy as a whole. Academic research showed that a larger size can be accompanied by a more important risks diversification (Demetz and Strahan, 1997) and reduces the individual probability of failure, hence such a contagion risk (Craig and Santos, 1997, Demetz and Strahan, 1995, Dermine and Schoenmaker, 2010, Hugues, Lang, Mester and Moon, 1999).

This is consistent with banking recent history. For years, size and access to a large customer deposit base were considered as positive; positive for the consumer as it enlarges the product offer and allows competitive prices through cost efficiency; and positive for financial stability through risk and funding mitigation combined with business and geographic diversification. Supervisors themselves were strong supporters of such policy, encouraging banking consolidation everywhere. The quality of the banking system has been consequently and significantly improved. It is therefore hardly understandable that a regulatory reform discourages such a banking consolidation (the private one that does not involve taxpayers’ money) that may be whished in the medium-long term to increase global financial stability by rescuing the small and medium size impaired banks that are presently creating systemic problems in some parts of the world.

3 – Additionally, it is important to consider that the bigger the traditional banking system, the smaller the unregulated and unsupervised shadow banking system and the risks it places on the economy and on unprotected actors. From a global systemic risk perspective (and not only banking-induced one), this should be recognized as an incentive to avoid chasing the risk outside the supervised area. The banking system has proven its capacity, to a certain extent, to absorb shocks rather than amplifying or widespreading them to the remaining part of the economy as the markets did during the crisis.

4 - Last but not least, it has to be noted that the proposed individual indicator - Total exposures as defined for use in the Basel III leverage ratio - is partly redundant with the complexity individual indicator as the trading book and AFS assets will be accounted for twice.

3. Interconnectedness

§29 to §34

"3. Interconnectedness" suggests metrics to be used in the global score to determine that a bank is, or is not, a Global Systematically Important Bank (GSIB).

This "Interconnectedness"-component represents 20% in the global score and is broken down in 3 sub-metrics, each of them has the same weight (1/3rd in the "Interconnectedness" component, 1/15th in the global score):

1. intra-financial system assets
2. intra-financial system liabilities
3. wholesale funding ratio

In a nutshell, the comments are:

- all interconnectedness metrics should be derived from economic metrics rather than accounting-derived metrics, notably to avoid distortion between different GAAP (ex: US GAAP vs IFRS)
- Considering the deluge of regulations that banks have to abide by, the risks within the banking system should be considered within acceptable levels: each bank has necessarily a limited exposure to other financial institutions. At the very least, **different weighting factors should be given to financial institutions as a function of the regulatory framework they are subject to:** highly regulated institutions (ex: banks) should be given lower weighting factors than a lightly regulated financial institution (ex: shadow banking).
- **Benefits should be derived in the GSIB-score when transactions are spread over numerous counterparts** compared to a bank that would have the same "gross exposure" concentrated on a few numbers of financial institutions counterparts.
- **the netting mechanism** that is mentioned in intra-financial system assets and intra-financial system liabilities **should be consistent with the contractual agreements**. This leads to :
    - adopt an economic rather than an accounting perspective for the metrics (cf first bullet point above)
    - **net collateral value from secured lendings and secured borrowings and secured debt instruments** (that are considered gross in the suggested metrics);
    - **consider net exposure, by counterpart, on the scope of transactions that are covered by a netting agreement with that counterpart, including transactions that may be assets *and* liabilities** (ex: derivatives, repos/reverse repos).
- **The wholesale funding ratio** as suggested is at odds with the goal that it is destined to. Since banks are subject to liquidity risk requirements through BCBS-LCR, which should be uniformly determined and required across jurisdictions, **there is no need to embed a liquidity risk component in the GSIB-score. Should BCBS decide to retain such a metric, we suggest leveraging as much on the LCR-reporting template to determine the exact categories that BCBS is willing to focus on**.

3.a. Metrics should be economic-driven rather than accounting-derived:

So as to meet the objective and to avoid being spoiled by different accounting standards (ex: US GAAP vs. IFRS), the interconnectedness-metrics should be economic-driven rather than accounting-derived.
When accounting netting mechanisms do not match the contractual risk netting mechanisms, the interconnectedness-metrics should be based on the contractual agreements rather than accounting netting mechanism.

3.b. Comments an the first two metrics: intra-financial system assets and liabilities:

3.b.i. Absent a clear definition of "financial institutions", the GSIB-score will be flawed:

The first two metrics focus on transactions with financial institutions. However there is neither a clear definition of financial institutions, nor any distinction between categories within "financial institutions".

Absent a clear definition, the metrics could not be compared across different jurisdictions, which will be a fatal flaw in the design of the GSIB-score since banks will be ranked based on inhomogeneous metrics. The "metric normalization"-process will magnify these biases.

As an example, should US Agencies, such as Fannie Mae, Freddie Mac, G. Mae and Federal Home Loan Banks, be classified as financial institutions?

- if yes, their debt should be excluded from the liquid assets in the Basel III-Liquidity Coverage Ratio (LCR), and the transactions with those institutions would weigh GSIB-score;
- if not, it would distort competition between the US and the rest of the world (reminder: together, US Agencies' assets represent roughly 40% of US GDP).

Other examples (among others that are identified in the Basel III framework):

- should Central Bank be considered as financial institutions? Most probably not since banks which are regulatory-wise incentivized to shun the interbank market will be led to grow their transactions with central banks. This also applies to LCR-liquid assets since banks, not willing to increase their exposure to sovereigns, will be led to increase their deposits to central banks, which are part of the LCR-liquid assets.
- should CCP be considered financial institutions? Most probably not since CCPs help reduce the systemic risk (ex: CDS)

3.b.ii. Financial institutions should be broken down in sub-categories:

In the suggested metrics, "financial institutions" are considered as if it was *one* financial institution. This is an overly simplistic assumption since it ignores the key dimensions listed below:

- financial institutions are subject to different regulatory frameworks: banks are notably subject to the Basel III framework, insurance are subject to Solvency II framework, whereas hedge funds are subject to minimal regulatory requirements. **Transactions with counterparts that are subject to strong regulatory framework should not weight on the GSIB-score: those transactions should be excluded from the GSIB score**, or at the very least be allocated lower weighting factor, derived from the strength of the regulatory framework.
- Financial institutions have different perspective: does it make sense to consider transactions with a life insurance company similar to transactions with a private equity fund? The ramifications of a default of one institution are most probably different between different types of financial institution.
- The metrics consider that a transaction with one financial institution is similar to numerous small transactions with numerous different financial institutions. However, **the systemic risk should be considered smaller with the spread over numerous counterparts, even among numerous financial institution counterparts**. Note that, when those counterparts are subject to capital requirement and exposure concentration constraints, the systemic risk (contagion risk from one bank to another one) *is* mitigated. This is another reason to breakdown financial institutions by type of regulation they are subject to.

3.b.iii. "Net" should be defined and extended to cross assets and liabilities, when applicable:

The first two metrics refer to a "net" approach for reverse repurchase agreements and repurchase agreement, securities lending and securities borrowing, OTC derivatives.

However, the metrics consider assets and liabilities separately. **It would make more sense to adopt a net approach, by counterpart, netting all transactions with a counterpart** (notably assets *and* liabilities) **to the extent that it is consistent with contractual agreement** (example: netting repo and reverse repo with a same counterpart when a master-repo agreement contract exists to net both in case of default).

Besides, secured lending and secured borrowing, including secured debt, should be considered *net* of collateral, rather than on a gross basis, as is suggested (since lending and borrowing to financial institutions are not broken down into secured and unsecured categories).

3.b.iv. It is impossible to reliably measure its debt securities that are owned by financial institutions:

Marketable debt securities are… marketable, which means that once they are issued, it is not possible to determine the debt holder.

As is suggested, the "securities issued by the bank that are owned by other financial institutions" is not audit trailable, which is a material flaw to determine a score that may lead to additional capital requirement.

3.b.v. Off balance sheet commitment should be applied weighting factors:

Lastly, considering undrawn committed lines for their gross notional value vastly overestimate the exposure: at the very least, committed lines should be weighted (ex: weighting factors could be found in LCR and NSFR as suggested by Basel III).

3.c. Comments on wholesale funding ratio metrics:

The wholesale funding ratio suggested in §34, that is "[total liabilities – retail funding] / total liabilities" is completely at odds with the objective that it is assigned to in §33 that is focused on short liabilities, coming from financial institutions, to finance illiquid assets.

The suggested ratio fails on all fronts:

- it does not consider the term of the funding (the longer the lower the liquidity risk);
- it is not focused on funding from financial institutions since the [total liabilities – retail funding] is far broader than financial institutions and notably comprise: derivatives' value in the balance sheet, funding from SMEs, PSEs, Governments, Central Banks, private placement and even equity!
- it ignores the asset side of the liquidity equation (ie: the "illiquid assets" component that is referred to in §33.

As bank will be subject to binding LCR, that should be uniform across jurisdictions, the liquidity risk will be very strictly limited: **why should GSIB-score try to overly simplistically address what is addressed in a liquidity-specific, very detailed and very demanding constraint in Basel III?**

Besides **the renormalization process that is applied on this wholesale funding will magnify the measurement biases in the ratio**.

We suggest deleting this sub-component.
Should a liquidity-centric sub-component remain, we suggest leveraging on the data collected for LCR, which will help collecting data on gross basis, focused on short term funding from financial institutions (or sub-categories of), and avoid the renormalization bias.

4. Substituability

§35 to §42

The custody business is largely concentrated in the US but it is not the case in other part of the world, including in Europe. Even in the US, the custody services remain a highly competitive business with a number of institutions providing those services. Clients (both institutional clients and investment banks) have a large choice of service providers and regularly challenge their current provider by launching request for proposals to other providers. In addition already today many clients have not concentrated their assets into a single provider but are using at least 2 providers. Clients having already contractual relationship with other custodians can easily and rapidly transfer their securities to their other providers should the first one faces difficulties.
We therefore questioned that custodians are considered as institutions hardly substitutable.

- Counterparty exposures

Clients and financial institutions have by nature limited counterparty exposure towards a custodian. Clients mainly deposit securities with a custodian. Those securities are protected from the custodian bankruptcy as they are segregated from its own assets. Clients' assets are off balance sheets items and although they may be blocked for a limited period of time during the liquidation period, all clients would recover their securities assets. The Client exposure towards a custodian is limited to the cash deposit related to the clients securities account. Using the amount of asset under custody as indicator is therefore not relevant to assess the counterparty exposure and the level of G-SIBs.

5. Complexity

§43 to §51

A measure of complexity has been added to the Basel Committee indicator-based measurement approach on the ground that G-SIBs with greater complexity are likely to be more difficult to resolve and therefore cause significantly greater disruption to the wider financial system and economic activity. It should be noted that this indicator was not part of the IMF/BIS/FSB October 2009 guidance.

In the Basel proposal, complexity is captured through three sub-indicators:

- the OTC derivatives gross nominal or notional value
- the total value of level 3 assets
- the total value of securities holding in the trading book and available for sale categories

Hence, while the announced objective is to capture business, structural and operational complexity, the proposed sub-indicators are in fact essentially about size.

As already mentioned, there will be no benefit for the banking industry as a whole to cut the complexity indicator since scores are based on ratios of a bank over all banks within the panel indicators. Some of the sub-indicators might even turn relatively meaningless as their importance dwindle. For instance, as more and more derivatives get cleared, amounts of OTC derivatives will be lower and its use as an indicator of complexity might become more and more questionable and should probably not attract the same weighting when this adjustment occurs.

<u>B – Bucketing approach</u>.

§52 to §55 + Annex 1

A noticeable point of the proposed approach is its deliberately linear character (calculation of the score, definition of the buckets and allocation of the capital by bucket). In such a context, one would expect on the contrary to find increasing cost functions as well in the assessment of the systemic importance of an institution as in its capital charge.

The conventional character of the approach, joint with his linear fit, facilitates its appropriation by the G-SIBs and potential G-SIBs. This should encourage them to set up programs aiming at reducing some (or all) of their systemic indicators so as to reduce their add-on in capital. This target is unfortunately scrambled by what can be seen as factors of potential instability, intrinsic to the adopted approach. For example:
- the “non-systemic” bank of reference whose characteristics compared with those of the systemic banks are used to fix the additional loss absorbency is the 28th bank according to its sytemic importance i.e the first of the not-systemic banks of the population of the 73 establishments selected a priori. This choice would deserve to be justified. A more permanent point of reference could, for example, being obtained:
- by retaining the median or the average of a sample of about twenty banks centred on both sides of the 28th bank;
- by setting a norm of social acceptability, whose level could initially be based on the 28th bank of the panel, but which would be expressed in proportion of a macroeconomic indicator (GDP) so that it would not be supposed to vary thereafter due to the relative or collective behaviours of the banks in the panel. Indeed, one does not see which reason could justify the variation of the socially acceptable loss fixed in proportion of the GDP, in the course of time.

<u>C – Supervisory judgement</u>

§56 to §67

Contrary to what has been made for the RWA calculation, the proposed indicator-based approach is purely mechanical and it does not give way to an expert judgement. In theory, it closes the door to any discussion.
However, in the proposal the BCBS half-opens a door with a possible correction by national regulator, on a case-by-case basis. But one does not see precisely on which criteria a national regulator will be able to dispute the amount of additional loss absorbency without calling into question the approach as a whole.
This opportunity given to national regulators could appear to be critical in a context of new risks emergency.

The ignorance of the quality of the orderly resolution plans put in place by major banking institutions (i.e. how operational they are) prompts a number of comments:
- Since the objective of the plans is precisely to reduce the systemic impact of a default, they should be taken into account in determining the additional loss absorbency requirement.
- Not taking them into account runs counter to providing an incentive to financial institutions to alter their degree of systemic risk and, more generally, to put such plans in place in a realistic way.

- It is understandable that this might raise a number of problems as part of an approach which, as has already been stressed, is based on a framework of quite general agreements; that would lead to the systematic reintroduction of judgment in assessing the systemic importance of an institution.
- The footnote (no. 16, page 11) drives the point home by stressing the enforced nature of the Recovery & Resolution Plans (RRP) exercise. It creates a link between the quality of an RRP and the fear of a sanction, in this case a discretionary additional bucket of capital which would be on top of the systemic loss absorbency requirement discussed in the document. This unfortunate footnote also perhaps reflects a certain reticence (whether justified or not) on the part of the members of the BCBS committee to accept as hard currency future plans which will have been approved by national regulators.

More generally, this part opens the door for "host" regulators to question and dispute a decision taken by the "home" regulator and its board. The phrase "if they involve a material impact in the treatment of the specific bank" does not look strong enough to limit the excesses (questions, requests for specific work, meetings) of local regulators, which might feel affected at their level: for example, in a case where an entity is regarded as systemically important at a local level when the banking group to which the entity belongs would overall be considered generally of lesser systemic importance by the home regulator. This kind of situation, and even general cases where the banking group's status as systemically important would not be in dispute, will automatically lead to questioning of the links between the legal entities, business lines, processes and portfolios within the group in question. These are all matters that are likely to be the responsibility of the home regulator which will, after all, have the RRP.
How the dialogue between regulators is to take place is not defined and the responsibilities of the home regulator in these discussions are not stated particularly vigorously.

<u>D – Periodic review and refinement</u>

§68 to §72

The periodical review of the indicators is indeed the best way to create an incentive within the banking groups concerned. But still it would be necessary that the approach shows the characteristics of permanence (= stability) required (see before).

A coherent system is expected. However the fact that a credible RRP (Resolution and Recovery Plan) does not favourably impact the measure of the systemic importance of a bank is eloquent. The overall coherence of the device being not guaranteed, the implementation of this proposal should be postponed.

III – The magnitude of additional loss absorbency and its impact

§73 to §79 + Annex 2

The methodological consistency of the whole approach is not guaranteed. The estimate of the additional loss absorbency requirement is based on a bundle of three approaches, which are not repositioned one relative to the other.

The alternative methods used lead to very different results the one from the other, which demonstrates how weak they are.

In its study of the long-term macroeconomic impact[9], the BCBS emphasises that the same increase in solvency ratios leads to a decline in the probability of crises that is particularly sensitive if the initial ratio level is low. In other words, an additional layer of capital on top of the minimum requirement would have a modest marginal effect on reducing default probability, but would still have just as significant an economic cost. The LEI's work suggests that the benefits would exceed the costs up to a TCE/RWA boundary of 10% (no permanent effect) or even 13% (moderate permanent effect). This result is based on very strong underlying assumptions and should be used with great caution.
The empirical results also seem to have a bearing on reducing the probability of a crisis and not on the probability of individual default, which is different. At this stage, there is nothing to support the conclusion that raising initially identical solvency ratios would reduce the individual probability of default to the same extent, independently of the institution's size.

[9] - "An assessment of the long-term economic impact of stronger capital and liquidity requirements", BCBS, August 2010

This maximum boundary of 13%, tested under Basel II standards, is translated to Basel III by applying a multiple of 0.81, which is the inverse of the average multiple between Basel II and Basel III RWA (i.e. 1.23, equating to an average rise of 23%).

The linearity (economic costs) or non-linearity (economic benefits) of the effects obtained results at least as much from the assumptions applied and from the model specifications used as from the data observed. There are also questions about the relevance of migration from Basel II to Basel III for G-SIBs, which is the same as for other banks, even though the composition of G-SIBs' portfolios imply increases in RWA that are probably larger than those of banks in group 1 in the BCBS/CEBS impact studies. Assume, for example, that the average increase in RWA for G-SIBs in the move from Basel II to Basel II.5 then Basel III is 35% (which is similar to Barclays' situation), the maximum Basel II CET1 ratio of 13% would equate to a maximum bucket of 2.5% not 3.5%.

The Basel II to Basel III conversion factor also ignores adjustments, with no justification. In fact, Basel III adjustments amounted to 41.3% of gross Tier One common equity for the 87 group 1 banks in the BCBS December 2010 impact study. What is more, as for RWA, this is only a floor since adjustments are undoubtedly proportionately larger for the 28 G-SIBs.
If both RWA and adjustments are taken into account, the 13% boundary under Basel II, above which the economic costs become larger than the economic benefits according to the LEI's research, becomes 8.12% once translated into Basel III standards for the major banks in group 1 of the QIS and probably still less for the G-SIBs (see Appendix). In addition to a minimum 7% requirement, the proposed buckets would lead to very high levels that are well above these limits and therefore do not look justified and may be economically damaging.

IV - Instruments to meet the additional loss absorbency requirement
§80 to §89 + Annex 3

See comments page 8 and 9

V - Interaction with other elements of the Basel III framework
§90 to §95

This new capital requirement can lead to a double counting between the Pillar 2's capital requirement of G-SIBs and their considered additional loss absorbency which is supposed to cover negative externalities only. As mentioned in the proposal, Pillar 2 may need to adapt. The home regulator will be responsible for that adjustment, which opens the door to a "patriotic" arbitrage in favour of the bank under its responsibility.

VI - Phase-in arrangements
§96 to §97

We urge the BCBS, especially in view of recent events showing how fragile the credit conditions and investor confidence remain, to reconsider the phase-in arrangements proposed for the G-SIBs reform and delay them until the full effects of the incoming Basel III reform are enforced for all banks. This delay will also allow to consider other, possibly more appropriate, means of regulating these G-SIBs and will make it easier for the banking system to build up its capital without any adverse consequences on the global economy (for instance too tight credit restrictions).

As a matter of fact, the above argument was acknowledged by the Macroeconomic Assessment Group (MAG) in its August 2010 publication, 'Assessing the macroeconomic impact of the transition to stronger capital and liquidity requirements'. Indeed, the MAG concluded that "A longer implementation period [for the tighter capital requirements] would (a) give banks more time to adjust their business models and cost structures, (b) allow more time for stable non-bank channels of credit intermediation to develop, (c) reduce the severity of the impact of lending cuts on bank-dependent sectors, and (d) give markets more time to absorb the asset sales, debt issues and equity issues that might accompany balance sheet adjustments by banks. Thus, a longer implementation period would be likely to *reduce* any negative impact [on GDP] resulting from the requirements".

The MAG also underlined, amongst the factors likely to deepen the negative impact on GDP of tighter capital requirements, any “limits to the ability of markets to rapidly accommodate the balance sheet adjustments desired by bank, [including] the ability of markets to absorb (a) new issues of bank equity, (b) new long-term debt issues to replace short-term liabilities and fund additional liquid asset holdings, and (c) any assets that banks may wish to shed”. It appears clear that the current situation exhibits such limits, and is likely to remain so for a few years at the least. This could be especially damaging if, as likely, market players were to require from the various banks that they comply with the new requirements ahead of the time when those became legally enforceable.

Moreover, the fact that the Basel III framework has a universal reach and is relevant to the whole of the banking system while the G-SIBs reform concerns only a small number of banks (as obvious in the fact that only 73 institutions were selected into the sample surveyed) shows clearly that the two are separate reforms. As a result, there is no sensible ground in linking the phase-in arrangements of those reforms without any other motivation (such other motivation being absent from the Consultative Document).