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August 25, 2011

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

Dear Sir/Madam:

Re: CBA[1] Comments on the Basel Committee's Consultative Document:
Globally systemically important banks: Assessment methodology and the additional loss absorbency requirement

Thank you for the opportunity to comment on the Basel Committee on Banking Supervision's (Basel Committee) Consultative Document entitled Global systemically important banks: *Assessment methodology and the additional loss absorbency requirement* (Consultative Document).

Please note that, whilst we do not support the identification of Globally Systemically Important Banks (G-SIBs) since we believe that such identification will lead to the perception that governments will support G-SIBs irrespective of the level of risk that they undertake (i.e. moral hazard), we acknowledge that international initiatives in this regard are proceeding. This will have an impact on individual banks, domestic regulators, policy makers and financial markets. Consequently Canadian banks have a stake in this and we present our comments on the Consultative Document in this context.

For your consideration, below is a summary of our key concerns. Additional detailed discussion on specific paragraphs is included in the attached.

Lack of transparency and its consequences

We are most concerned with the fact that the proposed methodology set out in the Consultative Document is not sufficiently transparent to permit a rigorous analysis of the impact of the proposals. As we understand the proposals, there are two primary goals. The first is to identify

[1] The Canadian Bankers Association works on behalf of 52 domestic banks, foreign bank subsidiaries and foreign bank branches operating in Canada and their 267,000 employees. The CBA advocates for effective public policies that contribute to a sound, successful banking system that benefits Canadians and Canada's economy. The Association also promotes financial literacy to help Canadians make informed financial decisions and works with banks and law enforcement to help protect customers against financial crime and promote fraud awareness. www.cba.ca.

and rank banks as systemically important as per the methodology in the Consultative Document. All such banks would then be subject to a resolution framework, as outlined in the Financial Stability Board's (FSB) Consultative Document "Effective Resolution of Systemically important Financial Institutions". The FSB's framework would assist authorities in resolving, without systemic disruption and without taxpayer exposure to risk, G-SIBs that are in the process of failing. In addition and as outlined in the Consultative Document, an additional loss absorbency requirement would be imposed depending upon the score of the bank – the amount of extra capital would range from a low of 1% to a maximum of 3.5%, and it would all have to be in the form of common equity.

The second goal is to create incentives to manage the size, complexity and business model of a bank so as to balance off a bank's assessment of the benefits to growth, diversification and business lines against the capital surcharge.

This lack of transparency has serious consequences, both for individual financial institutions and the market as a whole. Banks do not have a clear understanding as to where they are positioned in the G-SIB rankings. Consequently, they do not know how, or to what extent, to manage their business models in the event their business strategy was not to become a G-SIB.

However, the methodology makes it difficult for an individual bank to calculate its own score as it is based on the score of other banks in the sample. An institution's score could increase, and potentially cause the institution to cross a threshold, simply because other financial institutions have reduced their activities in one or several categories.

Concerns about the methodology

While the above mentioned feature of the methodology makes complete transparency difficult, it also represents a significant methodological flaw in our view. It creates uncertainty which may lead to sub-optimal results with respect to strategic planning and lead to investor confusion and/or apprehension. Moreover, it makes it difficult for individual banks to manage their activities because they would be subject to collateral impacts from the behaviour of other banks.

In this regard, we believe the methodology is flawed because of its heavy reliance on relative scoring. We agree that indicators need to be calculated relative to some benchmark but if the benchmark is just other firms in the sample; the indicators will miss industry wide changes in behaviour. If the financial sector gets less risky as a whole, the indicators may not fully pick that up. Similarly, if the sector gets riskier as a whole, the indicators might not fully reflect that. As such, we believe that an absolute (instead of relative) assessment of systemic importance should be adopted.

Flexibility

With respect to the classes of instruments considered to meet the additional loss absorbency requirement, we are of the view that G-SIBs should be afforded the flexibility to use a broad range of capital instruments, not only common equity. Alternative instruments will have a lower cost compared to common equity and will aid G-SIBs in raising capital in the market.

Future re-assessment of methodology

We appreciate that the development of the G-SIB assessment methodology and the additional loss absorbency requirements set out in the Consultative Document are only in the very early stages of development, and acknowledge that there are many complex and analytical challenges that will be addressed by the Basel Committee in due course. As such, we could appreciate the opportunity to re-assess the proposed framework at a later point in time when the methodology is more developed.

In conclusion, in order to prevent unintended consequences, the FSB should announce its plans with respect to the extension of the framework to financial market infrastructures, insurance companies and other non-bank financial institutions that are not part of a banking structure quickly and exhaustively. And whilst we recognize the need to improve the quality and consistency of data that banks are required to provide, efforts should be made to minimize the burden on banks resulting from such requirements.

We thank you for taking our comments into consideration and would be pleased to discuss these issues further at your convenience.

Sincerely,

Attachment: CBA Detailed Comments

CBA comments on BCBS Consultative Document – Global systemically important banks: Assessment methodology and the additional loss absorbency requirement

CBA Members' Comments and Requests for Clarification

OVERALL COMMENTS

- Further to our comments concerning the effect that the G-SIB surcharge could have on banks' business models, we further note that the G-SIB surcharge could encourage the use of the 'originate and distribute' model by banks (which was one of the reasons for the recent financial crisis) as well as discourage consolidation of the industry for the benefit of the client and/or inhibit the acquisitions of distressed or failed institutions.
- We are concerned about the challenges (uniformity, currency conversion, accounting regimes) associated with creating a database that is respected by both the industry and markets. We believe that strong coordination between regulators with respect to the definition of 'financial institution' is required.

II. Assessment methodology for systemic importance of G-SIBs

A. Indicator-based measurement approach

- The Basel Committee has used an equal weighting approach. Has the Basel Committee considered differing weights? Is this something that will be considered as part of future reviews of the methodology? *(paragraph 16)*

Cross-jurisdictional activity:

- We believe that the definition of "cross-jurisdictional activity" should allow for the netting of local currency assets and local currency liabilities rather than measuring them separately within the cross-jurisdictional calculation. Because jurisdictional assets are measured separately from jurisdictional liabilities, the present definition provides incentives for cross- border funding which is more risky than the practice of match funding of local currency assets with local currency liabilities.
- We are of the view that there should be a distinction between regulated and unregulated exposures. Banks have exposures in various jurisdictions for different reasons. *(paragraph 18)*

CBA Members' Comments and Requests for Clarification

- Could the Basel Committee clarify how the impact of hedges will be considered? Will it be treated based on the jurisdiction of the hedged counterparty? Should the cross-jurisdictional assets and liabilities be netted for this calculation? *(paragraph 18)*

Size:

- In addition to the size indicator itself, a number of sub-categories relate to size (thus potentially creating a duplicative effect that may distort size as a component of a bank's score). How has this been taken into consideration by the Basel Committee? *(paragraph 27)*
- The utilization of the exposure measure used for the leverage ratio to measure the size indicator raises outstanding questions regarding the leverage ratio exposure measure with respect to netting and off-balance sheet exposure. *(paragraph 28)*

Interconnectedness:

- Intra-financial system assets: Could the Basel Committee please clarify whether holdings of securities of other financial institutions should include index exposures? *(paragraph 30)*
- We do not believe that it is appropriate to equally weigh 'intra-financial system assets' and 'intra-financial system liabilities' since extensive liabilities pose greater systemic threat than assets. *(paragraph 32)*
- Wholesale funding ratio: In isolation, the wholesale funding ratio does not recognize the liquidity framework that is being implemented to match asset maturity with the term of liabilities. This may penalize banks holding more capital, notwithstanding that the incremental liquidity risk has been mitigated through the liquidity framework. *(paragraph 33)*

Substitutability:

- Values of underwritten transactions in debt and equity markets: We are not convinced that this indicator is appropriate in view that underwriting functions were easily replicated or purchased upon the failure of banks during the recent financial crisis. *(paragraph 41)*

Complexity:

- OTC derivatives notional value: We are uncertain as to whether the OTC derivatives notional value is a good indicator of complexity. We are of the view that back to back derivative exposures should be netted. *(paragraph 44)*

CBA Members' Comments and Requests for Clarification

B. Bucketing approach

- Could the Basel Committee clarify how the reference point will be set-up for the fifth bucket (above D)? *(paragraph 55)*
- Could the Basel Committee disclose the threshold for the buckets? *(paragraph 55)*

C. Supervisory judgement

- The Consultative Document does not include dispute resolution provisions that deal with differences of opinion between stakeholders including the FSB, the Basel Committee and home/host regulators. This is particularly concerning as the proposed surcharge appears to allow a bank's home and host regulator as well as a regulator in a completely different country to challenge its indicator-based score. We are of the view that home regulators should be the authority better placed to make the final call. *(paragraph 56)*

Ancillary indicators:

- Non-domestic revenue as a portion of total revenue: We believe that this metric should be based on sustainable income (NII) rather than a one-off fee income. *(paragraph 58)*
- Equity market capitalisation: We do not believe that this category should qualify as a metric. For example, a bank could successfully implement a business model not related to the 12 indicator-based measurement approach and still increase its market capitalization. *(paragraph 61)*

Process for incorporating the supervisory judgement:

- We are concerned that home/host regulators' views can be very subjective. *(paragraph 66)*

D. Periodic review and refinement

- We are concerned as to whether the frequency of these reviews is sufficient; especially given the surcharge methodology is only in its infant stages. *(paragraph 69)*
- Could the Basel Committee clarify whether banks will be able to migrate annually between buckets? If so, we are of the view that this will create uncertainty in long term decision making. *(paragraph 70)*

CBA Members' Comments and Requests for Clarification
▪ We believe that data integrity is a key issue. *(paragraph 71)* ▪ Could the Basel Committee clarify the related incremental disclosure requirements for both G-SIBs and non G-SIBs? What additional G-SIB related disclosures will be required (e.g. information related to various indicators, relative ranking etc)?
III. The magnitude of additional loss absorbency and its impact
A. The magnitude of additional loss absorbency ▪ Whilst we note that in Section II. B., Bucketing Approach, Paragraph 55, the Basel Committee includes the significance of cliff effects as a consideration, there is still a large cliff effect for each score in terms of incremental capital requirements. *(paragraph 73)*