Basel update to the core principles for effective Banking Supervision

- Comments by the British Bankers' Association -

Introduction:

The British Bankers' Association ("BBA") is the leading association for banking and financial services in the UK, representing 230 banking organisations from 60 countries, and 40 professional service firms within our associate membership. The BBA welcomes the initiative on revising the core principles for effective banking supervision and is pleased to respond to this consultation[1].

The BBA shares BCBS' objective of effective banking supervision, and supports the revision of the core principles to take into account lessons learned during the global financial crisis. The core principles should be designed to encourage an approach to banking supervision that is embedded in the culture of both firms and the supervisory organisations. The BBA welcomes the shift in approach away from the 'box ticking' exercises that we have seen in the past and to developing coherent supervisory practices globally. The BCBS' updates to the 2006 principles are largely welcome, and in many areas the BBA has no further comments to make.

One topic that we feel has been overlooked is the area of macro-prudential supervision. This has been a focus since the crisis and marks a major shift in supervision, although it has not been explored in great detail in the updated principles. The notion of macro-prudential supervision raises various questions over how it would fit with the principles detailed in the BCBS proposals, for example the move to macro-prudential supervision could affect the accountability and independence of banking supervisors. We believe this needs further thought and consultation with the industry, once the Financial Stability Board has finalised its work on macro-prudential policy toolsets.

In addition, the European Commission is currently forming its own view about crisis management and is preparing to consult on legislation that will introduce a European crisis management framework. In due course, we would expect to see the outcomes from this process incorporated into the BCBS principles, where relevant, in order to assist cross-border banks and supervisors.

The principles focus on bank "safety and soundness", however given the specific UK reforms, we would also encourage a reference to the need for banking supervisors to cooperate/coordinate effectively with the other supervisory authorities. For those that operate as a single regulator, there is a need to ensure an appropriate balance between prudential and conduct of business supervision.

<u>Comments on specific principles:</u>

In relation to principle 1, the BBA shares the notion that supervision has a key role in promoting and improving the risk management practices that are employed in banks. Making sure supervision is 'right' is a common goal for both industry and the authorities; this includes ensuring that there are clear objectives established via a legal framework that is accessible and equally applied to all. The BBA believes that it is essential that there is communication with the industry in terms of what the role and powers of supervisors are so the transparency the

[1] http://www.bis.org/publ/bcbs213.pdf

principles bring is welcomed. We believe it is important that the authorities have the appropriate tools to carry out the tasks within their respective remits.

With regard to principle 2, we would like to reiterate the point that for supervision to be effective, supervisors must be able to fully understand the risk profiles of individual firms. Supervisors should have the independence and expertise to analyse information and make judgements, but be able to call upon third party expertise where necessary to supplement this expertise. Supervisors should also be held accountable for those decisions that they make by being subject to public scrutiny. It is essential that supervision takes account of the nature, scale and complexity of the individual institutions within the industry in which they operate, and are proportional in their approach in order to optimise the use of supervisory resources.

As focused on in principle 3, the BBA is a keen supporter of recovery and resolution planning as a key tool to ensure that essential functions of a failing bank can be preserved and unviable parts wound down without damaging economic stability. So we support the new criterion that processes are in place for the supervisor to support the resolution authority in its role.

We believe the greatest challenges in this area arise in the case of banks which operate across international borders using a mix of subsidiaries and branches. It is important in such cases that robust memoranda of understanding between home and host supervisors of international banking groups are established and we suggest that criterion five of Principle 3 be expanded to encompass this, perhaps using wording such as:

> *Processes are in place for the supervisor to support resolution authorities (e.g. central banks and finance ministries as appropriate) to undertake recovery and resolution planning and actions <u>and that where necessary Memoranda of Understanding which describe the roles of home and host supervisors in the case of the failure of an internationally active bank should be signed</u>*

Although we support recovery and resolution planning and are firmly committed to it as a complement to the Basel III ‘more capital, more liquidity requirements’ and as mitigant to the possibility of a gSIB buffer, importantly we believe that there are two distinct phases. Firstly, the recovery phase during which the management of the bank remains firmly in the hands of bank management and secondly, the resolution phase which is clearly the responsibility of the resolution authority.

Whilst during the recovery phase we recognise the ability of the supervisor to require management to consider a range of recovery options the final decision, about which alternative to utilise and when, remains the responsibility of the incumbent management.

We welcome the statement in principle 8 that any such measures must take into account their impact on the soundness and stability - and therefore franchise value - of the ongoing business, but suggest that this should be reinforced by making this more clearly a requirement.

> *Any such measures <u>shall</u> take into account their effect on the soundness and stability of ongoing business and the preservation of its franchise value.*

Principle 13 focuses on the home-host relationships between the supervisors of cross-border banking groups. Banks are well aware of the benefits that a more harmonised and convergent global regulatory architecture can bring and actively encourage regulators to cooperate and harmonise their activities. Colleges of supervisors can provide the right model for the supervision and regulation of globally active banking groups and build the mutual understanding and trust that is so important in crisis resolution. The BBA believes colleges should be flexible

tools designed to meet the supervisory needs of individual cross-border financial institutions and their families of supervisors.

The addition of principle 14 on corporate governance is consistent with the UK Corporate Governance Code, emphasising the need for Board members with relevant skills and experience, and highlighting the need to align remuneration with a prudent risk appetite. The role of the regulator as an important instrument in an effective system of corporate governance is highlighted and we agree that it is for the regulators to provide guidance to banks on the expectations for sound corporate governance. The BBA believes that any proposed corporate governance measures should be based on the principle of proportionality. Whilst size is one criteria on which a company may be judged, the BBA considers that this alone should not determine its governance arrangements. Any guidance should enable companies to adopt corporate governance measures in a way that reflects their business model, the national frameworks in which they operate and promotes the stable economic growth of the company.

In principle 15, we support the suggestion that the supervisor should work closely with the resolution authority. We envisage that there would be increasingly close cooperation depending on the 'closeness' to the point of non viability, ranging along a continuum from business as usual, where no significant interaction would be required in our view, to immediately prior to the point of failure where the resolution authority will become the dominant partner.

We also support the recognition of the concept of proportionality embodied in their assessment of a bank's risk profile and systemic importance. Simpler banks, operating entirely within a single jurisdiction should not be required to prepare overly complex recovery plans. We expect the resolution powers currently being put in place would include a bank insolvency process that would be the default option for dealing with the failure of non-systemically important banks.

Once the revision of the Core Principles has been finalised, and following a suitable period permitting any necessary changes to supervisory practice to be introduced, it is important that peer reviews of the supervisory approaches adopted by different jurisdictions are undertaken and supported with proper feedback in order that the full benefit of the strengthened Core Principles can be captured.

Please do not hesitate to contact me for any question you may have on our submission.

Yours sincerely

Holly Jones