The voice of banking
& financial services

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baselcommittee@bis.org
c/o the Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

Dear Sirs

A framework for dealing with domestic systemically important banks

The British Bankers' Association ("BBA") is the leading association for UK banking and financial services for the UK banking and financial services sector, speaking for over 230 banking members from 60 countries on the full range of the UK and international banking issues. I am pleased to say that all the major banking players in the UK are members of our association as are the large international EU banks, the US banks operating in the UK and financial entities from around the world. The integrated nature of banking means that our members are engaged in activities ranging widely across the financial spectrum encompassing services and products as diverse as primary and secondary securities trading, insurance, investment banking and wealth management, as well as deposit taking and other conventional forms of banking.

The BBA is pleased to respond to the consultation on a framework for dealing with domestic systemically important banks.

General comments

The BBA fully supports the objective of developing a framework to assess and mitigate the potential impact that the distress or failure that domestic systemically important banks (D-SIBs) would have on a domestic economy. We agree that enhanced regulation of D-SIBs, alongside that of global systemically important banks (G-SIBs), would be an important step towards ensuring the better regulation of the banking industry and increasing financial stability.

While the principles outlined in this consultation paper are in the right direction, there are certain areas that need further guidance from the Committee. This extra detail would form the basis for a clearer regulatory framework, a more transparent process, and an effective assessment of D-SIBs and their impact on the domestic economy. We believe the Committee should build a general D-SIBs assessment framework which national authorities would then further develop based on the idiosyncrasies of their own domestic economies, but would still ensure internationally consistently in tandem with a rigorous and transparent approach.

Please find our comments on consultation questions in the annex below. We hope these comments are useful and the BBA would be delighted to provide any future assistance we can.

Yours sincerely

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Annex

Principle 1: National authorities should establish a methodology for assessing the degree to which banks are systemically important in a domestic context.

We are supportive of the notion that national authorities should establish the methodology for assessing the degree to which banks are systemically important in a domestic context. However, the methodology needs to be refined (please see our comments on Principles 2, 5, 6 and 10), and there needs to be appropriate checks and balances on the exercise of the methodology (comments on Principles 7, 8, 11 and 12).

Principle 2: The assessment methodology for a D-SIB should reflect the potential impact of, or externality imposed by, a bank's failure.

We agree that any methodology should reflect the potential impact of,a bank's failure. In addition, it should reflect factors which influence the risk of a bank getting into difficulties and its eventual failure (the 'probability of default' profile). To omit such factors from the regulatory framework would fail to incentivise banks' adoption as going concerns of prudent, effective risk management and of structures which, in extremis, would make them more easily resolvable.

Principle 3: The reference system for assessing the impact of failure of a D-SIB should be the domestic economy.

We agree that the reference system for assessing the impact of a failure of a D-SIB should be the domestic economy. However, the phrase "domestic economy" itself requires further definition, and the initial factors that should be considered with regards to this definition need to be outlined. While we agree that each national regulator should take into account the idiosyncrasies of their own domestic environments, there needs to be some initial prescribed principles that are to central in the decision-making framework. This is critical in ensuring both a level playing field and a transparent framework for dealing with D-SIBs. We recommend the Committee drafts the initial principles, and then release them for public consultation.

Principle 4: Home authorities should assess banks for their degree of systemic importance at the consolidated group level, while host authorities should assess subsidiaries in their jurisdictions, consolidated to include any of their own downstream subsidiaries, for their degree of systemic importance.

We agree that home authorities should initially consider banks from a globally consolidated perspective as experience has shown that any failures will have a significant impact on the domestic economy. However, in the case of a bank that is merely a subsidiary member of an international banking group we believe a better approach would be to assess it in relation to its own sub-group, leaving the wider group out of consideration. This is consistent with the general direction of regulation (and indeed of this framework) is towards insulation of domestic economies and individual financial services providers from the contagion of banking failure.

Principle 5: The impact of a D-SIB's failure on the domestic economy should, in principle, be assessed having regard to bank-specific factors:
(a) Size;
(b) Interconnectedness;
(c) Substitutability/financial institution infrastructure (including considerations related to the concentrated nature of the banking sector); and
(d) Complexity (including the additional complexities from cross-border activity).
In addition, national authorities can consider other measures/data that would inform these bank-specific indicators within each of the above factors, such as size of the domestic economy.

The Committee developed a detailed framework for the assessment of G-SIBs. For D-SIBs, four of the five categories from the G-SIB indicator-based measurement approach are included (size, interconnectedness, substitutability and complexity). We agree that the fifth indicator (cross-jurisdictional activity) is not particularly relevant.

However, we do not agree with the Committee's assertion that a similar degree of detail is not warranted for D-SIBs. We agree that there needs to be flexibility to allow each national regulator to take into account the individual considerations of their own domestic economies, and we agree that unlike the G-SIB framework, the D-SIB framework should be a principle-based approach. However, this does not mean there cannot be a detailed starting framework for D-SIBs endorsed by the Committee; the two are not mutually exclusive.

A lack of at least a basic framework will most likely result in significantly different criteria being developed and applied by each regulator, which in turn will result in an unlevel playing field, which could in turn lead to moral hazard.

A universal framework will also help promote transparency. If each national regulator is the final arbiter with regard to its own rules, it will almost certainly lead to international regulatory misalignment. Further to this, local framework and resulting decisions should be put into the context of a framework developed by the Committee. We are of the opinion that a clear framework set by the Committee can be applied in conjunction with a jurisdiction's individual idiosyncrasies.

Principle 6: National authorities should undertake regular assessments of the systemic importance of the banks in their jurisdictions to ensure that their assessment reflects the current state of the relevant financial systems and that the interval between D-SIB assessments not be significantly longer than the G-SIB assessment frequency.

We support the Committee's view that there should be a consistent approach to the ongoing management and assessment of both G-SIBs and D-SIBs. This would offer a number of benefits; for example, if a firm was likely to change from being a G-SIB to a D-SIB (or vice versa) it would make sense for both to be reviewed at the same time. For firms that are both a G-SIB and a D-SIB to the home regulator it would also enable more efficient alignment of any resulting changes to regulatory requirements.

Clearly, D-SIBs can be as important relative to their 'reference system' (see Principle 3) as G-SIBs are in their global context. Based on this we would recommend that the Committee instead should make this a formal requirement, rather than saying it would be "good practice" for national authorities to review potential D-SIBs, and it would be "desirable" that the interval of the assessments be no longer than for G-SIBs,

Principle 7: National authorities should publicly disclose information that provides an outline of the methodology employed to assess the systemic importance of banks in their domestic economy.

We suggest that national authorities should publicly disclose specific details of any methodologies they use for assessing D-SIBs, not just "an outline of the methodology employed". This could include, for example, the sources of data and qualitative criteria used when applying supervisory judgment. This would provide markets and institutions with information necessary for a good understanding of the evaluation performed by the competent authorities.

We recommend that the Committee develops a framework that ensures national authorities go through rigorous due process, and that there is full and clear transparency around their methodology and decisions. This would allow the industry to feed back to the regulators in order to refine the methodology, and a enable institutions to assess their own businesses and why they are (or are not) considered a D-SIB.

Principle 8: National authorities should document the methodologies and considerations used to calibrate the level of HLA that the framework would require for D-SIBs in their jurisdiction. The level of HLA calibrated for D-SIBs should be informed by quantitative methodologies (where available) and country-specific factors without prejudice to the use of supervisory judgment.

We support the Committee's objective to ask for sufficient documentation from home and host authorities to ensure there is consistency across home and host authorities. The methodologies and related considerations should not only be documented but also published. This will reinforce transparency and foster more consistent application of the rules internationally.

Principle 9: The HLA requirement imposed on a bank should be commensurate with the degree of systemic importance, as identified under Principle 5. In the case where there are multiple D-SIB buckets in a jurisdiction, this could imply differentiated levels of HLA between D-SIB buckets.

We have no objection to this principle, but have some concerns that the proposed approach towards "bucketing", based on the "degree of domestic systemic importance", risks also creating a measure by which banks are predominantly assessed relative to their local peers. Consequently, banks may not benefit from improvements to their indicators, if all local banks do likewise. Given that the overall objective is to secure a reduction in the aggregate level of systemic risk, we consider it crucial that any bucketing approach is designed in such a way that it is accepted that, in principle, all D-SIBs could ultimately occupy the lowest tier.

Principle 10: National authorities should ensure that the application of the G-SIB and D-SIB frameworks is compatible within their jurisdictions. Home authorities should impose HLA requirements that they calibrate at the parent and/or consolidated level, and host authorities should impose HLA requirements that they calibrate at the subconsolidated/ subsidiary level. The home authority should test that the parent bank is adequately capitalised on a stand-alone basis, including cases in which a D-SIB HLA requirement is applied at the subsidiary level. Home authorities should impose the higher of either the D-SIB or G-SIB HLA requirements in the case where the banking group has been identified as a D-SIB in the home jurisdiction as well as a G-SIB.

In order for this principle to where an institution is both a G-SIB and a D-SIB in a particular jurisdiction, there needs to be very clear rules on the interaction and application of regulatory rules governing G-SIBs and D-SIBs. If this is unclear an institution sould potentially be asked to hold capital twice and therefore “double count”, which we do not believe is the objective of the proposals.

As in the majority of instances the home and host regulator’s will be based in different jurisdictions, it is a legitimate concern as to how the two regulators will communicate with each other, and it would be very easy to envisage a situation where firms are mistakenly asked to double count. Bearing this in mind the Committee needs to define the exact process that the two regulators need to go through when deciding on an institution in this situation and to ensure that the institution itself is able to state its case.

Principle 11: In cases where the subsidiary of a bank is considered to be a D-SIB by a host authority, home and host authorities should make arrangements to coordinate and cooperate on the appropriate HLA requirement, within the constraints imposed by relevant laws in the host jurisdiction.

We appreciate the Committee asks for home and host authorities to coordinate on the appropriate HLA requirement. However, the Committee needs to be more prescriptive on how the authorities should coordinate, what they should disclose, how they should use any data etc. Failure to do so could lead to unforeseen and unacceptable situations, for example, the double counting point as illustrated above under principle 10.

We suggest that the home authority should be given explicit responsibility for coordination with host authorities to ensure consistency, and avoid overlapping of capital requirements for a single group. This principle could be further expanded to stipulate the requirement for a college of supervisors to meet at least annually to discuss and agree D-SIB charges across all jurisdictions. It would be equally important in stressed or crisis situations (recovery and resolution planning and CMG having been coordinated by the home authority) that uncoordinated D-SIB requirements should not adversely impact upon the recovery/resolution process and the actual recoverability of cross-border groups.

Principle 12: The HLA requirement should be met fully by Common Equity Tier 1 (CET1). In addition, national authorities should put in place any additional requirements and other policy measures they consider to be appropriate to address the risks posed by a D-SIB.

We understand that the higher loss absorbency requirement for D-SIBs should be met with Common Equity Tier 1, as it is consistent with the additional loss absorbency requirement for G-SIBs.

However, if national authorities are to put in place any additional requirements, there needs to be a great deal more flexibility on what would make up any additional capital requirement. It should not be restricted to Common Equity Tier 1; for example, contingent capital should be considered as suitable for the composition of any additional buffer.

While we recognise the difficulties in defining the role of local regulators, we feel that the terminology ‘any additional requirements and other policy measures’ is too broad and should be made more specific with reference to measures and relevant provisions of the regulatory framework coming in to place.