European Association of Co-operative Banks
Groupement Européen des Banques Coopératives
Europäische Vereinigung der Genossenschaftsbanken

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Consultative Document *"A framework for dealing with domestic systemically important banks"*

Ladies, Gentlemen,

The European Association of Co-operative Banks (EACB) welcomes the opportunity to comment on the BCBS Consultative Document *"A framework for dealing with domestic systemically important banks".*

Please find our remarks on the following pages.

We will remain at your disposal,

Yours sincerely,

Hervé Guider
General Manager

Volker Heegemann
Head of Legal Department

GENERAL REMARKS

The EACB acknowledges the mandate from the G20 leaders for BCBS and FSB to extend the G-SIB framework to domestically systematic important banks (D-SIB). However, the similar line of thinking with the G-SIB framework might not be appropriate because the reference economy is not the same. We note that the D-SIB framework might have great consequence for most banks, in particular for banks of small countries and banking groups with significant presence in other countries.

Banks in smaller economies seem to be more affected than in bigger economies, since the criteria for designation as D-SIB are relative ones. International banking groups domiciled in small countries will nearly always find themselves identified as D-SIBs. We completely understand that even a relatively small bank might pose high risks and might lead to potentially negative effects for the economy of a small country in case of a crisis situation (see the case of Island and Ireland). However, we think that more consideration should be given to supranational economic effects of the proposed framework.

The consequence of applying this framework can result in higher CET-1 requirements, which potentially restricts the granting of loans by credit institutions especially in small economies and thus create structural problems compared to other countries. We question therefore whether an additional capital add-on is the right solution and rather believe that a stronger supervisory scrutiny might have better targeted effects.

Moreover, such measures could create an uneven playing field and competitive disadvantage for banks in smaller economies. This could lead to distortion in certain economic areas, like the EU and seems incompatible with the spirit of such economic areas.

In case a capital add-on is unavoidable, in order to reduce the potential burden and impact on the economy, we strongly advocate that when fixing the level of HLA for D-SIB, the maximum level of the HLA should not be higher than the minimum level under G-SIB rules. The overlapping between D-SIB and G-SIBs should be avoided for clarity reasons by implementing the condition that a (parent) bank which is a G-SIB cannot also be a D-SIB. Its subsidiaries could be D-SIBs. Furthermore, a D-SIB HLA imposed by host authorities should be recognised as minimum capital requirement at the group level (from the perspective of minority interest).

Further thought should also be given to the possibility of meeting additional capital requirements with non-CET1 instruments, e.g. contingent convertible instruments.

The relation between Pillar II and D-SIB should be specified in detail as these two similar frameworks might lead to double counting of risks.

RELEVANCE OF REFERENCE ECONOMY

We understand the BCBS perspective that D-SIBs can be susceptible of bringing down an economy. Such cases should of course be avoided in the future. However, the proposed framework might lead to competitive distortions and might be counter-productive. The reference economy and market is of key importance. In contrast to the G-SIB framework where the reference economy was the international economy, the D-SIB framework is addressed to national economies. This is especially disadvantageous for smaller countries as their international banking groups might always become D-SIBs while this will not be the case for similar banking groups from bigger countries. The framework might have unintended consequences especially in the case of highly fragmented regions with banking groups active across a couple of countries. Competitive distortions should be avoided as much as possible.

We therefore think that the paper should address the situation of single economic areas composed of many states. We strongly believe that the application of D-SIB rules should be done, in the case of such areas, like the European Union, at area level and not exclusively focused on the national markets.

The proposed framework might give rise to incentives that are not aligned to the intended results and that may lead to unplanned consequences. The main reason for this is the difference in the reference economy across the different subsidiaries of a bank. The implementation of D-SIB framework could have following consequences:

- The transfer of parent banks of small jurisdictions into big jurisdictions, while leaving behind the local banking operations in the small jurisdiction. This would make the former home country a host country. Under this scenario D-SIBs might get lost as issuers in the local stock market.
- Reorganization of subsidiaries into branches, thereby weakening the host regulators.
- Reduction/sale of cross-border business of D-SIBs would weaken the macroeconomic position of D-SIB home countries. (This effect is in contradiction with the principle of freedom of capital within the EU)
- CET-1 requirements for D-SIB will have to be held in local currency thus increase FX risks for the banking group as a whole. Assuming that economies and thus currencies of host regulators are weaker than those of the home regulator, this will require the parent companies to hold even more equity.
- A fragmentation of the banking markets of smaller countries creating considerable inefficiencies, competitive disadvantages compared to larger economies, adverse economic development and a de-facto termination of the freedom of capital for banks.

HOME AND HOST SUPERVISORS

There will be a potential conflict of interest between the home and host authorities regarding the decisions to apply an additional requirement. According to the proposed framework, "*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 sub-consolidated/subsidiary level*.[1]" In addition "*the home authority should test that the parent bank is adequately capitalised on a standalone basis, including cases in which a D-SIB HLA requirement is applied at the subsidiary level*[2]". However, as the paper correctly analyses[3] "*an action by the host authorities to impose a D-SIB HLA requirement leads to increases in capital at the subsidiary level which can be viewed as a shift in capital from the parent bank to the subsidiary*". Principle 11 requires home and host authorities to "*make arrangements to coordinate and cooperate on the appropriate HLA requirement*". This requirement however may be watered down as host authorities can always argue that they have to stay "*within the constraints imposed by relevant laws in the host jurisdiction*[4]". Home authorities will be more or less dependent on host regulators which in general set the legal capital requirements in their jurisdictions. It thus becomes necessary that the BCBS takes a much stronger position on this issue. A decision taken at a national level concerning a subsidiary should only be taken at the level of the college of supervisors and should be done in coordination with the home authority. In other words, this should be managed in a consolidated way by the home authority.

Moreover, the possibility of the subsidiary to raise additional capital "*from outside investors*"[5], which could potentially alleviate part of the problem presented above, may be not a real option, depending on the calculation method implemented by EBA and other supervisors. It might lead to deductable minority interest on parent level according to Basel III or CRR and consequently further weaken the position of the parent bank.

The problem seems more acute when the parent bank is relatively small compared to the consolidated group. In reality this could lead to the impossibility to repatriate profits from host countries. Consequently the paper does not only put banking groups from small countries at a disadvantage, but also restricts the freedom of capital (one of the fundamental freedoms of EU).

[1] Principle 10
[2] Principle 10
[3] Paragraph 37
[4] Principle 11
[5] Paragraph 37

NATIONAL DISCRETION VS. FREEDOM OF CAPITAL

The document does not indicate any limit value for the HLA or supervisory measures, which could be used. While a certain degree of national discretion is welcomed, a minimum set of requirements should be ensured. Moreover, we believe the methodology should have clear and public provisions, especially relating to the categories of banks. Such precision would ensure international convergence. Otherwise, the ample space for the national discretion might lead to an unlevel playing field for international banks even though "*consistent, coherent and non discriminatory treatment regardless of ownership*"[6] is demanded. In order to partly alleviate this problem principle 1 should be implemented as transparent as possible.

The rules for the co-operation between host and home regulators are complex and contradicting. This could create wrong incentives and possibly lead to a de-facto termination of the freedom of capital inside banking groups. It could also result in a fragmentation of the financial markets and in an adverse impact for the economic development of smaller countries.

CAPITAL CALCULATION AT SOLO LEVEL

We are particularly concerned about paragraph 37 in the context of principle 10. Local regulators may compete to get as much capital as possible within their own jurisdiction. Paragraph 37 recognizes this effect and could be interpreted in a way that it almost introduces a new capital requirement at solo level of the parent bank. The wording seems to suggest a capital calculation based on a deduction of the book value of international subsidiaries. Such a concept would not be in line with Basel 3 or CRR requirements and it should be clarified that this concept is not intended by the Consultation paper.

Similarly, as regards minority interest, where we Basel 3 has imposed stricter standards, there seems to be a more flexible approach for D-SIBs. This would be inconsistent and we fear that contradicting targets water down desired effects of the individual regulations

We agree with Basel Committee that there is a need to evaluate the impact that a failure of a bank can have. However, if the assessment methodology focuses solely on LGD of a bank and not to the PD[7], it gives little effect to good governance and effective risk management practices. This might lead to a too high, partly unjustifiable HLA for relatively lower-risk banks, with effective governance and risk management practices, and low incentives for improving these.

We note the intention of Basel Committee to "*provide the appropriate incentives to banks which are subject to the HLA requirements to reduce (or at least not increase) their*

[6] Paragraph 36
[7] Principle 2

systemic importance over time"[8]*.* While we completely understand the need to reduce the potential impact of a bank failure on the economy, we nevertheless wonder whether the objective mentioned in paragraph 34 is appropriate. This could potentially have serious effects on the economic growth. It would also penalize successful banks for growing market shares.

[8] Paragraph 34