European Banking Federation

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Set up in 1960, the European Banking Federation is the voice of the European banking sector (European Union & European Free Trade Association countries). The EBF represents the interests of some 5000 European banks: large and small, wholesale and retail, local and cross-border financial institutions.
The EBF is committed to supporting EU policies to promote the single market in financial services in general and in banking activities in particular. It advocates free and fair competition in the EU and world markets and supports the banks' efforts to increase their efficiency and competitiveness.

Subject : EBF response to the BCBS consultation on a framework for dealing with domestic systemically important banks (D-SIBs)

Introduction

The EBF welcomes the opportunity to share with the Basel Committee (BCBS) the views of the European banking sector on the proposal for a framework for dealing with domestic systemically important banks (D-SIBs).

It is understood that international policy makers intend to complete the work initiated in 2011 with the framework for global systemically important banks (G-SIBs) by putting forward a similar one for D-SIBs. It is therefore imperative to repeat the EBF advocacy[1] towards the G-SIBs framework as expressed in our response to the BCBS consultation run in July and August of 2011. On that occasion, the EBF acknowledged the merit of developing an early and simple G-SIB framework, however it should be adjusted so as to ensure that it portrays to a greater extent the genuine sources of systemic risk. This remains an opportunity for further improvement.

The EBF considers that the most effective policy tools to address the threats posed by systemic risk are improved supervision and resolution frameworks. Additional loss absorbency, though swifter to implement, can only be a complementary measure. It should be recalled that it implies a significant cost in terms of economic growth. For this reason, the EBF would like to remark that the currently proposed D-SIB framework should not replace nor take priority over the mostly needed improvements in supervision and resolution tools. Furthermore, the methodology

[1] See the EBF response to the BCBS consultation on the assessment methodology and the additional loss absorbency of Global Systemically Important Banks (G-SIBs) of 26 August 2011.

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proposed to identify and address D-SIBs should be subject to an informed and structured impact assessment.

Against this background, the EBF recommends that the extension of the SIB framework to domestic institutions should be designed with respect for the following principles:

- To put the proposed measures in the context of a wider range of policy tools for systemic risk prevention in which SIB buffers are just a complementary measure that does not entirely tackle the causes of systemic risk.

- To keep the capital buffers under a rather limited level.

- To avoid as much as possible complexity, wrong incentives and divergences that could only give rise to uneven playing field situations.

This EBF response puts forward opportunities for improvement of the proposed framework so that it contributes to restoring confidence in the banking sector whilst minimising the costs associated with its implementation.

Of a particular interest to the EBF is the interaction between the systemic risk framework proposed by the Basel Committee and the proposals that European policy makers have included in the capital requirements regulation (CRR) and directive (CRD4) underway. In this respect, the EU is already foreseeing very ambitious additional measures for SIFIs. It would not be acceptable that both regimes, the global and the European, be additive and expressed in different terms. Consistency with the global prudential framework is essential for a coherent systemic risk framework.

Last but not least, the EBF recalls that the higher degree of harmonisation of the regulatory environment and supranational institutional supervisory framework in the EU (i.e the European System of Financial Supervisors) should be taken into account in the rules governing the systemic risk framework. All the more considering the recent statement endorsed by Euro Area governments in support of the European Banking Union at the Summit on 28-29 June 2012.

In this respect, a clear definition of the requirements to be fulfilled for a set of countries to be considered as an integrated area (e.g. with respect to resolution frameworks, supervisory mechanisms, pooled recovery and resolution funds and deposit insurance schemes) should be spelled out *ex-ante* in detail by the BCBS for a fair application of this framework.

The rest of the document contains the EBF views on the following matters:

1. The degree of national discretion.
2. Cross-jurisdictional consistency.
3. Non-banking entities.
4. The role of colleges of supervisors.

5. The autonomy of stand-alone subsidiaries.
6. Deposit guarantee funds.
7. Incentives to resolvability.
8. Interplay between the G-SIB and the D-SIB frameworks.
9. Domestic level playing field.
10. Similar frameworks for G-SIB and D-SIB.
11. Need for common indicators.
12. G-SIB scale as a cap to D-SIB.
13. Integration in Pillar 2.
14. The EU single market.
15. Global control of the implementation.
16. The probability of default.
17. Incentives to risk mitigation.
18. Size of the buffers.
19. Fixed range of capital.
20. EBF proposal for setting SIB capital requirements.
21. Proposal for countries home to D-SIBs only.
22. Proposal for countries home to G-SIBs.
23. Stability of capital planning.
24. Time to meet the HLA requirement.
25. Extension of the capital conservation buffer.
26. Identification of other policy measures.
27. Additional tier 1 capital.
28. Disclosure requirements.
29. Banking union in Europe.
30. Overall impact.
31. Impact assessment of the D-SIB methodology.

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Related documents: BCBS Consultative Document http://www.bis.org/publ/bcbs224.pdf.
EBF response to the BCBS consultation on the assessment methodology and the additional loss absorbency of Global Systemically Important Banks (G-SIBs).

Remarks on the assessment methodology

1. The proposed framework allows for a high **degree of national discretion** in the assessment of D-SIBs and the calibration of the higher loss absorbency (HLA) required. Further clarification on the methodology for assessing the systemic importance would be desirable for the sake of consistency. In preventing uneven playing field situations, the EBF would welcome that the Basel Committee elaborated more specific criteria thus narrowing the scope for divergent interpretations.

2. The framework should secure a **cross-jurisdictional consistency**. National ring-fencing and divergent requirements from different competent authorities of a cross-border group could lead to duplication of operations and resources, loss of synergies and higher funding costs.

3. Clarification should be given as to whether the assessment of systemic importance covers solely subsidiaries of the banking group, i.e. branches and **non-banking entities** are not considered.

4. The role of the **colleges of supervisors** should be highlighted. In fact, the HLA should ideally be established in the college by the cooperation and joint decision mechanisms already in place. This decision should be taken before any HLA requirement is imposed on a subsidiary bank, as rightly indicated in the consultation document (page10, point 42).

5. The model of **standalone subsidiaries**, i.e. autonomous in capital and liquidity, places effective barriers to risk contagion and represents the case where using consolidated data for a banking group would not be appropriate to portray the risk to the domestic economy.

6. For banking groups organised in standalone subsidiaries, the costs of potential failures are backed by the respective national **deposit guarantee funds**. **Taxpayers** only face up the costs associated with the potential failure of the subsidiary in their countries.

7. The **incentives to resolvability** should also be taken on board in the proposed model. As the rules text on the G-SIB framework sets out in paragraph 5, the impact of failure will be reduced through improvements in the recovery and resolution frameworks. Since the D-SIB framework also focuses on the loss-given-default concept[2], the methodologies developed by each supervisor should not overlook the quality and effectiveness of the recovery and resolution framework. Namely, the introduction of the crisis management framework in the European Union should be regarded as reducing the systemic importance of the institutions covered.

[2] Paragraph 13 of the D-SIB consultation paper.

8. There must be a clear rationale in the **interplay** between the **G-SIB** and the **D-SIB** frameworks to ensure that the latter does not exceed the former in terms of additional capital requirement. Otherwise, arbitrage and uneven playing field effects would become evident.

9. In order to ensure consistency between the G-SIB and the D-SIB framework, the sum of the D-SIB surcharges, including the one at the parent company level on a standalone basis[3], if requested by the home supervisor, would not then be greater than the consolidated G-SIB surcharge. This consolidated G-SIB surcharge should be set as an absolute cap by the BCBS to keep the whole framework in line with the FSB directions. Otherwise, the **level playing field** within the country would be affected and both frameworks could clash despite being originally conceived to deal with different policy objectives. In our understanding, the D-SIB framework is not supposed to address a question of geographical diversification but the loss given default in the domestic jurisdiction.

10. The EBF encourages the BCBS to set a **similar framework** for both G-SIBs and D-SIBs with the only exception of the cross-border factor that would only apply to the former. Its place and weight could be substituted with other domestic factors. It would avoid complexity, divergence and unfair situations, hence providing for a level playing field. Therefore, the range for the D-SIBs buffer should not exceed the range of the G-SIBs framework (upper limit of 2.5% or ultimately 3.5%).

11. In order to overcome the difficulties to determine systemically important banks in a national dimension (item 20) due to the different national characteristics, it will still be desirable that the Basel Committee develops a set of **common indicators**. These must indicate the level of the additional requirements in relation to the systemically importance assumed by the national authorities. This will increase the likelihood of a similar implementation and give useful information for the capital markets in the evaluation of the soundness of banks.

12. In short, the EBF proposes that the capital resulting from the **G-SIB** framework be **a cap** for the D-SIB one.

13. The D-SIB surcharge should be fully integrated into the **Pillar-2** discussion to avoid duplicating prudential measures such as buffers under Basel III and other macro-prudential measures.

[3] In order to avoid duplications, the systemic degree of the parent company must be calculated according to the stand-alone exposure of the parent company in its country of operation and not according to the consolidated group exposure.

14. When assessing the complexity factor, it should be taken into account that cross-border activity inside the EU has necessarily a lower risk profile, due to the existence of a **Single Market** (which will be reinforced with the EU crisis management framework underway and potentially with the proposal for a banking union).

15. There must be an effective **global control** of the consistent implementation of the framework throughout the world. The peer review is useful as an *ex-post* process. Nonetheless, there is need for an *ex-ante* control.

Remarks on the higher loss absorbency

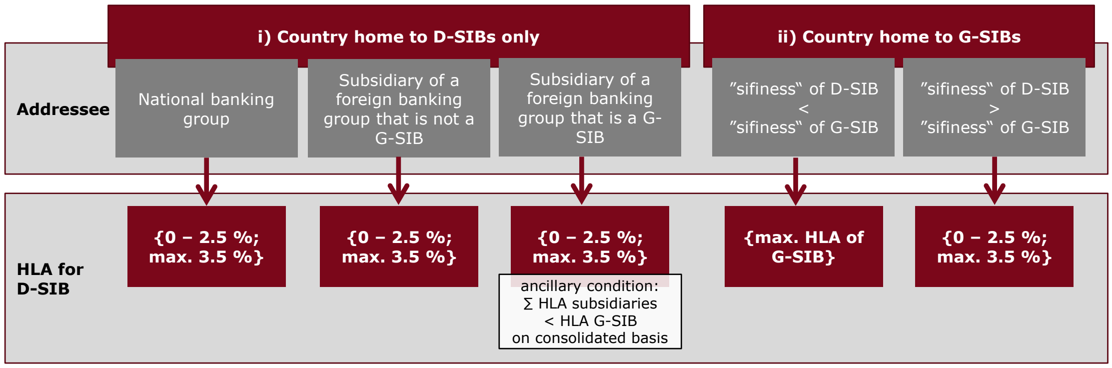
16. Though it is understood that the focus of the proposal is put on the impact of default, i.e. the loss given default, neglecting the **probability of default** may introduce a disincentive to run prudent managed banks.

17. The assessment should also take into consideration actions, policies or behaviours undertaken by the management of a bank to **limit the risk** related to its systemic relevance.

18. This proposal gives national supervisors a great deal of discretion in both the identification methodology and – in particular – in determining the **additional capital** requirements. Whilst the capital surcharges for G-SIBs are within a range of 1% - 2.5% (or ultimately 3.5%), no such limits are set for D-SIBs. It is therefore up to national supervisors to decide on the actual size of capital requirements for D-SIBs. For G-SIBs classified as D-SIBs, the cap of 2.5% (or ultimately 3.5%) proposed by the Basel Committee may therefore be exceeded. This discretion means that the G-SIB framework could potentially be undermined by the D-SIB rules.

19. The EBF is in favour of setting a **fixed range of 0% - 2.5%** (maximum) or ultimately 3.5% on a consolidated basis also for measuring the additional capital requirements for D-SIBs. This fosters capital market transparency and enables banks to plan their capital requirements accurately.

20. A **proposal for setting capital requirements** is illustrated in the following diagram. A distinction is made between (i) countries which supervise solely banks/banking groups that have obtained D-SIB status but not G-SIB status and (ii) countries which supervise at least one bank/banking group classified as a G-SIB at Basel Committee level:



21. (i) Purely domestic banking groups and subsidiaries of foreign banking groups without G-SIB classification are subjected to a capital surcharge of a maximum of 2.5% and in special cases to an extra bucket of additional 1% as envisaged in the G-SIB framework. The same rules apply to subsidiaries of foreign banking groups classified as G-SIBs, subject to the strict ancillary condition that the capital requirements at **group level may not exceed the relevant G-SIB capital surcharge**. This requires an appropriate coordination process between home and host supervisor. It would be desirable to clarify how this goal might be achieved in practice. The college of supervisors should play a key role, whereas the path towards a banking union in Europe should facilitate this issue in the future.

22. (ii) Where G-SIBs are concerned, the capital surcharge decided at Basel Committee level generally applies. The capital surcharge for D-SIBs should, in contrast, be geared to systemic importance, also compared with G-SIBs. If such **systemic importance** is lower for a D-SIB than for a G-SIB, the G-SIB capital surcharge is the maximum capital surcharge that should be applied to D-SIBs as well. If, on the other hand, the systemic importance of a D-SIB is higher than that of a G-SIB, the capital surcharge should be in the range of 0% – 2.5%, and 3.5% in exceptional cases. It may therefore be higher than the surcharge envisaged for a G-SIB but not above the G-SIB framework upper bound.

23. This proposal would ensure that the size of capital requirements is in a reliable and predictable range and **interaction between the G-SIB and D-SIB** frameworks is as smooth as possible. The EBF considers it essential that the size of capital requirements is predictable rather than subject to frequent changes that turn capital planning more difficult for banks.

24. Besides, as in the G-SIBs framework, BCBS should propose that authorities give their institutions **12 months to meet the HLA** requirement to allow their institutions a smooth transition. Furthermore, if the increase in the D-SIBs requirement is larger than 1%, authorities should ponder on whether to allow for a longer grace period (for instance, 18 months).

25. EBF encourages BCBS to estipulate that authorities implement the additional D-SIBs requirement through an **extension of the capital conservation buffer**, as will be the case in the G-SIBs framework. Hence, the division of the (extended) capital conservation buffer into four bands of equal size should be maintained[4].

26. For the sake of consistency, the Committee should identify and establish limits to the 'additional requirements and **other policy measures**' that national authorities could put in place as envisaged in principle 12.

27. In the view of the EBF, the requirement in Principle 12 to meet the capital surcharge solely with Common Equity Tier 1 (CET1) could be too narrow. As the loss-absorbing capacity of **Additional Tier 1** capital corresponds by definition to that of CET1, it is right to allow Additional Tier 1 capital to cover SIB requirements and to set up the capital buffer entirely in the form of Tier 1 capital.

28. Details of any related **disclosure obligations** should be defined in the D-SIBs ruling text.

29. The EBF is interested in the way the D-SIBs framework will be articulated with the implementation of a **banking union in Europe**. On the one hand it can be an opportunity to achieve more harmonisation in the implementation of the D-SIBs framework. On the other hand it may introduce a third layer of complexity if it is not articulated with the D-SIBs framework.

30. The **overall impact** of the capital requirements, a longstanding concern of the EBF, becomes all the more apparent when additional capital is required on top of the comprehensive Basel III framework. Systemic risk should be addressed through improved supervision and resolution frameworks in the first place, whilst excessive capital requirements may have an adverse impact on financial stability.

31. In the current circumstances of arrested economic growth, an updated assessment of the cumulative impact of all measures in place should be undertaken before adding to the already high capital requirement. In particular, the methodology proposed to identify and determine D-SIBs' additional capital requirements should be subject to a proper impact assessment.

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[4] As described in paragraph 147 of the Basel III rules text.