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Banking supervision
And Accounting issues Unit

The Director

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French Banking Federation comments on the Basel Committee Consultative Document « a framework for dealing with domestic systematically important banks » (June 2012)

Dear Sir,

The French Banking Federation (FBF) is the professional body representing the interests of the banking industry in France. Its membership is composed of all credit institutions authorized as banks and doing business in France, i.e. more than 450 commercial and cooperative banks. FBF member banks have 40,000 permanent branches in France. They employ 400,000 people, and service 60 million clients.

The French Banking Federation (FBF) welcomes the opportunity offered by the Basel Committee on Banking Supervision (BCBS) to comment on the proposed framework for dealing with domestic systematically important banks (D-SIBs). The FBF recognizes the importance of the work undertaken by the BCBS to address systemic risk posed to the whole economy by large and interconnected financial institutions. However, the FBF reiterates its general comment made in the context of the BCBS consultation on "Global systematically important banks: assessment methodology and the additional loss absorbency requirement". The French banking industry is of the view that the approach developed by the BCBS for dealing with systematically important banks, either on a global or domestic basis is inappropriate to preserve financial stability and detrimental for growth recovery and financing. The additional loss-absorbing capital charge to G-SIBs and D-SIBS will not decrease the probability of default for firms badly managed and inadequately supervised. Further, the French banking industry is increasingly concerned about the effects of numerous incremental layers of regulation and capital, liquidity, and collateral requirements on the banking system's ability to generate credit for recovery and ongoing growth.

Mr Xavier-Yves ZANOTA
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on Banking Supervision
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Regarding the D-SIB proposal, the FBF draws the BCBS attention to the following issues:

1. ***Level playing field***: the FBF supports the principle-based approach proposed in the D-SIB framework. However, as it currently stands, this framework implies a high degree of national discretion in the identification of institutions subject to the D-SIB treatment and to the calibration of the appropriate level of HLA capital charge. The FBF recognizes the recommendation made by the BCBS to national authorities for the public disclosure of their D-SIB methodology (Principle 7) and the necessity for home and host authorities to coordinate and cooperate on the appropriate HLA requirement (Principle 11). Nevertheless, French banks doubt that these recommendations will be sufficient to avoid any discrepancies in D-SIB approaches chosen by different national authorities. This will result, for internationally active banks, in multiple capital cushions for their different entities and possible double counting of HLA requirements between home and host countries. This issue is aggravated by the fact that the D-SIB proposal does not foresee any dispute resolution mechanism in case of disagreements between home and host jurisdictions on the appropriate level of a bank HLA. Therefore, some clarifications are needed in the D-SIB framework to address this issue.

2. ***Interaction between D-SIB and G-SIB frameworks***: There are four G-SIBs in France, which represent a substantial share of the national banking industry. The multiple layers of capital requirements imposed to those institutions could be highly detrimental for the banking industry and the economic environment as a whole. Therefore, we believe that the capital level of D SIBs, subsidiaries of G SIBs, should be discussed within the College of supervisors (within the Pillar 2 process). Moreover, all G-SIBs are in the process of drafting their Recovery and Resolution Plans (RRPs) as part of recent regulatory developments; an RRP will cover all the entities within a given G-SIB's perimeter, including all subsidiaries and branches. If done properly, these RRP may address most issues that D SIB may pose in their country. At last, there is already in place an efficient supervisory governance of cross-border banks through colleges and memoranda of understanding (MoU) between supervisors. As a result, national supervisors are able to monitor activities of banks within their jurisdiction and at the European level.

3. ***Limits to the D-SIB HLA surcharge:*** Given the existence of RRPs and the day-to-day activity of national supervisors, additional requirements for a D-SIB located within the same jurisdiction of its G-SIB parent will be redundant. In regard to the degree of discretion that national authorities should retain when defining a surcharge, the FBF believes that the framework should clearly establish limits to the level of HLA requirements that domestic authorities could impose. Such ceiling or cap would ensure maximum harmonization and avoid the pitfalls of an excessively fragmented framework across jurisdictions and the correlated problem of an uneven playing field. The D-SIB framework should establish, in a similar fashion to the G-SIB one, a gradual scale of capital add-ons, with a clear maximum amount that would serve as a cap. In any case, to preserve methodological consistency, French banks believe that the maximum capital add-on figure should be equal or less than that in the G-SIB framework (i.e. a maximum add on of 2.5% or 3%).

4. ***Exemption of local branches:*** The French banking industry believes that the text should state clearly that host supervisory authorities should not require HLA requirements at branch level too, which would be redundant with any parent charges and would be contrary to the principles set out in the BCBS Concordat.

5. ***Impact on cross-border groups:*** the D-SIB framework as it is designed would have an impact on the internal organization of cross border groups and may favour a "flat" organization over a pyramidal one. Indeed, the risk of incremental and potentially diverging national requirements from different competent authorities of a cross-border group could further lead to added complexities, costs, and inefficiencies in managing the group structure, for example by duplication of operations and resources, loss of synergies and higher funding costs. Having local offices identified as D-SIBs might therefore compromise the business models or strategic plans of financial entities, which could in turn decide to review their investments and business activities in jurisdictions, leading to a reduction of competition and credit provision in the local market, and to a loss of efficiency for multinational corporate clients, and for the system generally. The clarifications in the D-SIB framework proposed in item (1) above would contribute to avoid those negative impacts on cross-border groups comprising different D-SIBs in various jurisdictions.

6. ***Articulation with Pillar 2***: in the current Basel II framework, the possibility for home and host supervisors to impose additional layers of capital already exists under Pillar 2. Such additional capital cushions are deemed to reflect, for instance, the existence of risks that are idiosyncratic to a banking group entity or subsidiary in a specific country. Therefore, the co-existence of D-SIB and Pillar 2 frameworks can result in a double-counting of capital charges for the same risks. In order to clarify the articulation between the D-SIB framework and the Pillar 2, the FBF suggests that the latter be used by home and host supervisors in a structured discussion (e.g. within colleges of supervisors) to determine the appropriate allocation within the group of the HLA surcharge determined according to the D-SIB and, if applicable, the G-SIB frameworks.

7. ***Lack of impact analysis:*** neither the appropriateness and opportunity of additional capital buffers for D-SIBs nor the methodology proposed to address domestic systemic risks are supported by an informed and thorough impact assessment. As regards the appropriateness of an HLA buffer, the drawbacks mentioned above should be outweighed by the benefits expected from such a measure for the financial stability and bank soundness. However, this additional charge has not been tested nor discussed in an objective and transparent way. It should be noted also that many forces are currently driving up bank capital in addition to BCBS recommendations (i.e. national regulators, cross-national authorities and market participants). Any impact study on capital requirements (including for D-SIBs) should take into account this additional pressure on bank capital, which may already cover systemic risk. As regards, the methodology proposed to identify and address D-SIBS, the FBF supports the principles-based approach proposed. However, we would recommend testing and discussing further the 4 proposed indicators (size, interconnectedness, substitutability/financial institution infrastructure and complexity) on the basis of an informed and structured impact assessment.

You will find in the annex our comments on specific principles proposed in the consultation paper. We thank you for the consideration of our remarks and remain at your disposal for any question or additional information you might have.

Yours sincerely,

Jean Paul Caudal

Annex

In addition to the general comments, the FBF also submits specific comments on the principles set out for the assessment methodology and the HLA requirement.

1. ***Principle 9:*** the BCBS document is based on high level principles for the calibration of the appropriate HLA surcharge, without prescribing any pre-defined buckets, contrary to the G-SIB methodology. As it stands, this principle-based approach provides a high level of national discretion and does not set any upper limit to the maximum charge that a national supervisor can impose on a specific D-SIB. This has potentially highly disruptive effects on the level of CET 1 held by banks and on the way they can operate across juris0dictions., we cannot find any practical or theoretical justification to the fact that a D-SIB surcharge (expressed as a percentage of RWA) might be higher than the G-SIB one for the same group. French banks indeed consider that the G-SIB surcharge should constitute an absolute cap, either on a stand-alone basis or at a consolidated level. To avoid any overlap between the two frameworks, a cross-border institution identified as G-SIBs with D-SIBs subsidiaries, should be allowed to allocate this G-SIB surcharge among D SIB subsidiaries according to the Pillar 2 process (top down approach, and not the opposite).

2. ***Principle 10:*** this principle recommends that home authorities impose HLA requirements that they calibrate at the parent and/or consolidated level, and host authorities impose HLA requirements that they calibrate at the sub consolidated/ subsidiary level. In this respect, the FBF would like to make it clear that the D-SIB and G-SIB HLA requirements cannot be additive. Moreover, we are opposed to the proposal of testing the capital of the parent bank on a stand alone basis, because this conflicts with the principle of the supervision on consolidated basis, which has been clearly determined within the European Capital Requirement Directive, and denies the possibility for the mother entity to determine the appropriate capital allocation among subsidiaries as explained above.

   Finally, the FBF highly recommends that the BCBS state that a branch cannot be identified by its host supervisor as a D-SIB.

3. ***Principle 12:*** This principle stipulates that national authorities shall decide any additional requirements and other policy measures they consider to be appropriate. The FBF considers that the wording "any additional requirements" is too broad to be even considered as an internationally agreed principle. It opens doors to national discretions departing completely from any harmonisation or international consistency. The FBF recommends that the BCBS specify the meaning of "additional requirements" and eventually provide examples which can be envisaged without duplication with any other existing or upcoming prudential requirements. Further, the FBF is of the opinion that D-SIB requirements, if eventually pursued by the BCBS, could be met not only by CET 1 but also by other forms of capital which are eligible in Tier 1 and Tier 2 and present sufficient loss absorbing capacity (e.g. contingent capital). Any option in that matter should be thoroughly assessed and discussed between the BCBS and the industry.