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ASSOCIATION
OF
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香港銀行公會

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By email: baselcommittee@bis.org & post

Basel Committee on Banking Supervision
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

Dear Sirs

Consultative Document on a Framework for Dealing with Domestic Systemically Important Banks

We refer to the consultative document on a Framework for Dealing with Domestic Systemically Important Banks (D-SIBs) published by the Basel Committee on Banking Supervision (BCBS) in June 2012. On behalf of our members, we write to provide our views on the proposals in the consultative document.

1. Whilst we recognise that tackling systemic risk is a critical component of the overall regulatory framework, we believe that implementation of an additional capital buffer will not, in itself, make the banking system safer. We have concerns that there will be unintended consequences of such an approach, including increasing moral hazard, creating market-distorting effects and leading to a non-level playing field.

2. Putting aside our concerns over the conceptual nature of the proposed additional capital buffer, we recognise the need of a principles-based framework for dealing with D-SIBs to enable variations in domestic banking sectors and economies to be recognised but we are concerned that the approach proposed by the Basel Committee provides considerable scope for national approaches to vary significantly, leading to an unlevel playing field. To address these concerns, we would like to suggest the Basel Committee work with its members to develop a more detailed framework given the time available before its implementation from 2016. We would also like to know more about how the peer review process will work in practice and how it would encourage national authorities to fall in line with the framework for dealing with D-SIBs if they are seen to be inconsistent.

3. We believe that it is inappropriate to base the framework on a "loss given default" approach as this is contrary to the principles underpinning the risk-based approach of the Basel II capital framework. It is important that the likelihood (probability of default) of banks failing is taken into account which should be an integral part of banking supervision.

4. Whilst we appreciate the Basel Committee's rationale for not proposing the level of higher loss-absorbency (HLA) that should be set for D-SIBs, leaving this purely to the discretion of national authorities will inevitably lead to an unlevel playing field. We recognise that the intention is to ensure compatibility between the G-SIB and D-SIB frameworks and allow flexibility to accommodate the structural characteristics of individual jurisdictions, and for that the G-SIB framework sets minimum capital requirements. However, to ensure consistency of the application of HLA requirements for D-SIBs in different jurisdictions, we suggest that a cap be set. We believe there is a precedent in Basel III where the Basel Committee wished to achieve consistency in the application of the countercyclical capital buffer and the limit then of 2.5% could also be appropriate for D-SIBs.

   We would also like to clarify with the Basel Committee that home authorities should impose the higher of either the G-SIB or D-SIB HLA requirements only when the banking entity is both G-SIB and D-SIB in the home jurisdiction.

5. Our other major concern is that international banking groups may be required to hold overlapping capital buffers at the group, sub-group and subsidiary levels for the same underlying risks, if they are deemed to be systemically important at global and domestic levels. The approach proposed by the Basel Committee suggests close cooperation between the home and host authorities, but does not include any mechanism to prevent overlapping buffers from being set if the degree of cooperation is inadequate; indeed, it seems to encourage such a situation by proposing that home authorities set capital buffers at the group level recognising that foreign exposures within the group could give rise to systemic risks in the home economy. Host authorities setting capital buffers for the exposures within their jurisdictions would result in an overlapping buffer at the group level unless there is explicit recognition of the buffers set for foreign subsidiaries and branches. Certainly, we would envisage the capital regime for internationally-active banking groups to become extremely complex with the various capital buffers that have been proposed. It is important that the setting of capital buffers across an international banking group should be coordinated by the home authorities in cooperation with the host authorities of all the jurisdictions in which the group is assessed as contributing to systemic risk at the domestic level (through the supervisory college / crisis management group process). It should be noted that even extremely modest parts of a group may be deemed by the local supervisor to be systemically important

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from a domestic perspective and agreeing an approach involving many different regulators may require significant efforts to coordinate.

6. Recovery and resolution planning (RRP) should be a key factor in the assessment of systemic risk and in the need to set HLA requirements. We would like to see RRPs more clearly built into both the assessment methodology and the setting of higher capital requirements.

7. While the objective for imposing HLA requirements on D-SIBs is to limit the negative impact posed by banks on the domestic financial system and economy, the Pillar 2 regulatory add-on that banks are required to maintain aims to cater for unexpected losses beyond those covered by the statutory minimum capital requirements under Pillar 1.

   We are of the opinion that the two buffers are to a large extent overlapped as they both ultimately serve to limit the probability and impact of distress or failure of banks by raising the capital requirements and are set with reference to the size and complexity of individual banks. It is necessary for the Basel Committee to remind national authorities to review their Pillar 2 framework and to address the overlap. Together with the capital conservation buffer, the imposition of the D-SIB HLA requirements in addition to the Pillar 2 regulatory add-on may create undue strain on the capital-raising activities of D-SIBs.

We hope you would find our above comments useful. For any questions, please do not hesitate to contact us.

Yours faithfully

Ronie Mak
Secretary

c.c. Ms Karen Kemp, Executive Director (Banking Policy), Hong Kong Monetary Authority