



20/07/2012

Basel Committee on Banking
Supervision
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Consultative document - A framework for dealing with domestic systemically important banks

Introduction

The Swedish Bankers' Association would like to comment on the following issues in the consultative document

- The one-sided focus on LGD/ the impact of default relative to the PD/ the risk of default in Principle 2
- The consistency between the G-SIB framework and the D-SIB
- The lack of ambition to enforce international level playing field
- The restriction in principle 12 that HLA requirement should be met fully by CET1

Detailed comments

The one-sided focus on LGD/ the impact of default relative to the PD/ the risk of default in Principle 2

The impact assessment of the potential failure of a bank, as described in Principle 2, ignores the PD and concentrates solely on the LGD. This implies that only the potential impact of the default will be taken into account when assigning the size of the HLA.

By neglecting the probability of default, the degree of recoverability and the health of the bank in question, is ignored. A uniform sized HLA will thus be assigned to institutions which are assessed to have similar external impact in case of failure, regardless of the possibly large differences in the prospects to recover from different crisis situations, and the likelihood of ending up there in the first place. This will act as a disincentive to run prudent managed banks, as efficient risk management, and a diversified and well-balanced business mix (which minimizes the risk of failure) will not be acknowledged through a HLA reduction. As a consequence, the size of the HLA for well-managed, well-diversified, low-risk banks is likely to be overestimated.

Moreover, this approach to assessing the potential impact of potential bank failures also ignores the recovery part itself, and thus the sequence of management



mitigating actions and supervisory possibilities for early intervention, which front bank resolution.

The consistency between the G-SIB framework and the D-SIB framework

The G-SIFI assessment methodology framework (as introduced by the BCBS in November 2011) aims at identifying the banking groups which are sufficiently large to impact the economy internationally. The banks identified by this methodology, must cooperate with competent home and host authorities and establish plans for both recovery and resolution. Most of these represent banks whose potential default would impact the economy of several jurisdictions, and it is hence plausible that these G-SIBs contain several D-SIBs.

When making group plans, which naturally address the overall recovery and resolution aspects for the G-SIB, any national issues relating to recovery or resolution will be dealt with inside the frame of the overall plan. It is thus important to distinguish between stand-alone D-SIBs and D-SIBs which are part of a G-SIB.

The relevant host resolution authorities are represented in the Crisis management Directive for the G-SIB in question, which provides the necessary framework for the embodiment of domestic host resolution issues for the group subsidiaries. Domestic issues, where relevant, will thus be dealt with within the G-SIB framework, which makes additional D-SIB considerations for G-SIBs redundant.

The lack of ambition to enforce international level playing field

In order for banks operating as groups with centralised management of risk, liquidity and capital to be able to continue to doing so, it is of utmost importance, that the frameworks dealing with systemically important banks (whether in relation to G-SIBs or D-SIBs) as a minimum ensure full coordination of the actions taken, and the approaches pursued by the competent authorities. The ambition of ensuring level playing field must reach beyond the domestic economy, and be enforced internationally as well.

The consultative document leaves room for national discretion and policy judgment by national authorities when assessing the HLA and possible other requirements for a subsidiary of a cross-border group, which might lead to diverging requirements (despite the intention of the Committee to assess the cross jurisdictional consistency of the frameworks applied). National ring-fencing, and divergent requirements from different competent authorities of a cross-border group, could lead to an inability to uphold the group structure. This could lead to duplication of operations and resources, loss of synergies and higher funding costs.



Furthermore, efficient allocation of liquidity and capital within the group, as well as a diversified and balanced business mix, supports the recoverability. The recoverability will consequently be reduced if multiple recovery- and resolution jurisdictional regimes are allowed to co-exist.

The restriction in principle 12 that HLA requirement should be met fully by CET1

Principle 12 states that HLA requirement needs to be fulfilled by CET1. According to recent discussions it seems however that there is an increased flexibility from regulators on what will make up systemic buffers (specifically the global and/or domestic SIFI buffer), implying that also other capital instruments might make up some / part of the new buffers. As an example it can be read in the records of the latest financial policy committee meeting of Bank of England that "the required scale, and most appropriate means, of capital raising would vary across institutions. The weak profit outlook for banks would make it difficult to raise sufficient additional capital solely by limiting cash dividends and compensation. Banks might also issue equity or contingent capital instruments on terms approved by the FSA, incorporating high triggers for conversion."

Furthermore, a structural consideration must be made. Precise assignment of the risks on banks' balance sheets should always be observed. This in turn must be reflected in a precise mapping of the capital buffers needed to meet those risks, both in terms of size and nature. As the HLA requirement is intended to provide additional insulation against the tail risk event of default, it should be met with capital instruments, which are tailored specifically for this type of event, while still being fully loss absorbent. Contingent capital structures can serve these multiple purposes.

Maintaining a strict requirement for CET1, when meeting the HLA requirement, surpasses the goal of providing an appropriately tailored and precisely matched level of loss absorbing capital.

We would hence strongly support a regulatory development where also other capital instruments than CET1 can be used to meet buffer requirements. However, it is then essential that the regulatory framework is clear at this point, and introduced in a consistent way to ensure a level playing field.

SWEDISH BANKERS' ASSOCIATION


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