POSITION PAPER

WSBI-WSBI-ESBG Position Paper on the framework for dealing with domestic systemically important banks.

WSBI-WSBI-ESBG (World Savings Banks Institute – European Savings Banks Group)
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General remarks:

The World Savings Banks Institute (WSBI) and the European Savings Banks Group (ESBG) welcome the opportunity to provide a response to the Basel Committee on Banking Supervision's (BCBS) consultative document: "A framework for dealing with domestic systemically important banks". The WSBI-ESBG considers that this is a topic of extreme relevance for its members and for the whole banking industry.

First of all, the WSBI-ESBG would like to state that in the next years to come there will be many upcoming banking rules to be implemented. It seems to be wise to wait until all these regulatory changes are applied and then assess the results of the new regulation and whether further changes are needed. Therefore, before proposing any new framework, it is necessary to give the banking industry enough time to adapt to the current and shortly upcoming ones.

Generally speaking, the WSBI-ESBG is in favour of the strategy to strengthen the soundness and the stability of the financial system. Concerning the common framework to deal with the domestic systemically important banks, the WSBI-ESBG is rather in favour of addressing this issue and finding universal solutions as has happened with the G-SIB case. It seems logical that systemically relevant banks (G-SIBs and D-SIBs) will face stricter requirements, especially concerning capital levels, so that the *de facto* liability of the State in a crisis can be at least partially reduced.

The WSBI-ESBG welcomes that, whereas binding capital surcharges are planned for G-SIBs, a 'principle-based' approach has been chosen for D-SIBs.

The WSBI-ESBG would like to express its support to the idea of leaving the decision power of setting up higher loss absorbency requirements (HLA) at national discretion. National authorities are the institutions that have a better and close knowledge of the state of the financial system in every jurisdiction. National authorities should have discretion to accommodate the structural characteristics of their own domestic financial system, including the possibility for countries to go beyond the minimum D-SIB framework and impose additional requirements based on the specific features of the country and its domestic banking sector. However, the national flexibility of additional capital requirements for D-SIBs can potentially open the door to complete flexibility for national authorities to set the capital requirements that they want and thus undermine the international harmonisation. In this sense, a binding requirement for national authorities to justify and quantify the rationale for the HLA in as much detail as possible should be added (items 25 and 27).

Besides, the WSBI-ESBG would like to express its concerns regarding a potential lack of implementation of this framework in some jurisdictions. The BCBS should be very attentive to the different degree of willingness showed by the jurisdictions to apply such principles, which could

very likely lead to a competitive disadvantage for the European banking industry given that the European area is usually the first to comply with the BCBS recommendations.

Furthermore, the WSBI-ESBG agrees on the indicators selected to calibrate the systemic importance of financial institutions which are the same as those taken for the G-SIB (size, interconnectedness, substitutability and complexity; apart from cross border activity which has not been included in the D-SIB framework). Additionally, the WSBI-ESBG agrees with the idea of national authorities being able to include other measures/data that would provide better information on the state of national banks. The WSBI-ESBG also supports that national authorities should publicly disclose information that provides an outline of the methodology employed to assess the systemic importance of banks in their domestic economy.

Banks should be able to avoid additional requirements by reducing their systemic importance or the negative externalities that could arise as a result of a potential crisis. This can be accomplished by a reorganisation of the business or e.g. by reducing the banks interconnectedness.

Finally, the WSBI-ESBG is of the opinion that other solutions should be studied – not just the increase in capital requirements, but, for example, resolution plans. The solution to every problem in the banking system cannot always be the increase in capital requirements.

Specific remarks:

- Necessity of a coordinated process and cross jurisdictional consistency:

It is very important that the framework ensures a cross jurisdictional consistency (item 29). The flexibility and policy judgment by national authorities when assessing the HLA and other policy measures may lead to divergent requirements for a group of institutions. 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 WSBI-ESBG 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, the WSBI-ESBG doubts that these recommendations will be sufficient to avoid any discrepancies in D-SIB approaches chosen by different national authorities. This could 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.

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. For groups operating in several countries it is very important to ensure an efficient allocation of liquidity and capital, as well as to maintain a diversified and balanced business mix, all of which supports the recoverability of a group. The recoverability of a group will consequently be reduced if multiple recovery and resolution jurisdictional regimes are allowed to co-exist. The clarifications in the D-SIB framework proposed above would contribute to avoid those negative impacts on cross-border groups comprising different D-SIBs in various jurisdictions.

Furthermore, there is no specific proposal for a common process of evaluation of the HLA and the national policy measures for the D-SIBs, other than the reference to the Basel Committee's general processes for assessing the implementation on time and that it is consistent with the Basel III regulations. An observation process to review the calibrations and every national measure in order to ensure a level playing field (item 5) should be considered.

- Exemption of local branches:

The WSBI-ESBG 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 Accord.

- Need for consistency between D-SIBs and G-SIBs:

The institutions identified by the G-SIB methodology must prepare plans for both recovery and resolution. Potential default by a G-SIB would most likely impact the economy of several jurisdictions, and many of the G-SIBs contain several D-SIBs. National issues will be dealt with inside the frame of the overall recovery and resolution plan for a G-SIB. However, it is important to distinguish between stand-alone D-SIBs and D-SIBs which are part of a larger cross border group regardless of whether the group is labelled G-SIB group or not.

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. In the European Union the Crisis Management Directive proposal already envisages a framework of treatment for the G-SIBs that provides the necessary framework for the coordination of the domestic and host authorities when resolving a subsidiary of a G-SIB in a host country. . According to our mind this kind of framework is needed - and should hence be applicable - in all cross-border groups containing more than one D-SIB.

Furthermore, we consider that the capital level of D-SIBs, subsidiaries of G-SIBs, could 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 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 memorandum 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.

- 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 SIB 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."

The WSBI-ESBG supports 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.

- 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 WSBI-ESBG 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, we 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%).

- 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 WSBI-ESBG suggests that the latter should 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 framework.

- Avoiding a one-sided focus on LGD:

The framework recommends that only the potential impact of the default (item 13), such as a loss-given-default (LGD), will be taken into account when determining the HLA and other policy measures. However, there is inconsistency with principle 8 (item 28), which states that the HLA should be implemented in order to reduce the probability of failure (item 28). The Probability of Default (PD) should be also taken into account as a part of the assessment in order to fully consider the recoverability and the soundness of financial institutions. In order to create the right incentives the soundness of institutions should be fully considered in the framework. The assessment approach also ignores the recovery part itself, and thus the sequence of management mitigating actions and supervisory possibilities for early intervention, which should be a better solution than resolving a financial institution.

- 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.

In addition to the above comments, the WSBI-ESBG 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 jurisdictions., 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. The WSBI-ESBG indeed considers 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 WSBI-ESBG 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 WSBI-ESBG highly recommends that the BCBS states 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 WSBI-ESBG 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 WSBI-ESBG recommends that the BCBS specifies 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 WSBI-ESBG 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.

About WSBI-WSBI-WSBI-ESBG (World Savings Banks Institute – European Savings Banks Group)

WSBI-WSBI-ESBG – The Global Voice of Savings and Retail Banking

WSBI (World Savings Banks Institute) is one of the largest international banking associations and the only global representative of savings and retail banking. Founded in 1924, it represents savings and retail banks and associations thereof in 89 countries (Asia-Pacific, the Americas, Africa and Europe). It works closely with international financial institutions and donor agencies and promotes access to financial services worldwide in both developing and developed regions. At the end of 2010, assets of member banks amounted to more than $15,600 billion, non-bank loans of more than $8,300 billion and non-bank deposits of more than $8,600 billion. Together, member banks conducted operations through more than 227,000 outlets.

WSBI-ESBG (European Savings Banks Group) is an international banking association that represents one of the largest European retail banking networks, comprising about one-third of the retail banking market in Europe, with total assets of more than €7,470 billion, non-bank deposits of €3,400 billion and non-bank loans of €4,000 billion (31 December 2010). It represents the interests of its members vis-à-vis the EU Institutions and generates, facilitates, and manages high quality cross-border banking projects.

WSBI and WSBI-ESBG members are typically savings and retail banks or associations thereof. They are often organised in decentralised networks and offer their services throughout their region. WSBI and WSBI-ESBG member banks have reinvested responsibly in their region for many decades and are a distinct benchmark for corporate social responsibility activities throughout Europe and the world.

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