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Mr Bill Coen
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Basel Committee on Banking Supervision
Bank for International Settlements
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Dear Sir

Comments on BCBS 258 - The Regulatory Framework: Balancing Risk Sensitivity, Simplicity and Comparability

The substantial regulatory agenda that has consumed the banking and broader financial sector in the past few years has stretched the resources of policy makers, regulators and banks. Co-ordination of regulatory initiatives from various standard setting bodies has been difficult and the outcomes of these regulations on bank behaviour and economic activity are still uncertain.

It is encouraging that the Basel Committee on Banking Supervision has made the time to reflect and we thank you for the opportunity to comment on such an important paper.

Add: Question 1

<u>Does the current framework, with its reliance on the risk-based capital at its core, appropriately balance the objectives set out in Paragraph 29?</u>

We believe that a risk based approach to capital is both appropriate and necessary for the banking sector and that until there is global harmonisation in the application of the framework, the appropriate balance between the objectives will not be clearly determinable.

South Africa as a microcosm of the global banking sector, implemented Basel III on 1 January 2013. With the adoption of an IFRS accounting framework, all approaches under Basel II available to our banks and a compliance culture with best international practice has contributed significantly to the soundness of our banking sector. The adoption of the new Basel III capital disclosure templates, being used by our members, has significantly enhanced the comparability of the information available to the public. We believe that the investor community has adequate information at their disposal and combined with the willingness of the banks to educate investors on the latest reporting standards, has enabled a comfortable transition to the higher principles of disclosure.

We would suggest that global comparability may also be hampered by differences in accounting standards and the absence of a common interpretation of terminology and definitions. A single approach for Globally Systemically Important Banks, irrespective of where they are headquartered, may provide an important milestone to global harmonisation efforts.

Add: Question 2

<u>Are there other objectives that should be considered in reviewing the international capital adequacy framework?</u>

Supervision of the banking sector has evolved from managing an idiosyncratic failure to systemic risk management. Disclosure of key metrics during business as usual conditions need to be tempered with potential behaviour changing information in times of stress that could accelerate into a systemic failure. This does not reduce the importance of this information but the systemic impact of the disclosure, or non-disclosure in times of stress should be considered.

The advanced risk approaches offered under Basel II, provided an opportunity for a bank to be rewarded for a more sophisticated approach to risk management with a lower capital requirement. As the framework evolves, additional buffers, additional costs associated with advanced approaches and higher expectations from supervisors may temper the desire to transition from a standardised regulatory reporting framework to a more advanced approach. This does not mean that banks will not use more sophisticated approaches for their own internal risk management but it may dampen their appetite to use their models for regulatory capital reporting.

The level of capital adopted in a jurisdiction, should be appropriate for the nature of the banking activity in that jurisdiction. International financial centres can be expected to hold higher levels of capital whilst an emerging market may only be expected to adopt the minimum standard. This should be appropriate within the context of a global framework; however the calibration of the framework may need to be revisited.

Despite our support for global harmonisation we remain convinced that national discretion should be accommodated within the framework without diluting the principles. This was an important concession in the LCR proposals and similarly the capital framework could accommodate national discretion within Pillar 2 where it can be justified by the regulator.

Greater harmonisation between standard setting bodies to ensure that regulatory arbitrage and disclosure requirements are appropriate, globally adopted and do not unduly prejudice the banking sector.

Add: Question 3

<u>To what extent does the current capital framework strike the right balance between simplicity, comparability and risk sensitivity, given the costs and benefits that greater risk sensitivity brings?</u>

We believe that simplicity is an important objective; however our interpretation is that it should ensure that unnecessarily complex approaches are avoided and that the approach taken is appropriate for the entity being regulated. The banking sector is by its very nature complex. It is therefore important to recognise that the end user of the information must be in a position to understand the nature of the business and despite the desire to simplify; regulators and supervisors would need detailed information to perform their functions.

A key consideration for global comparability could be the regulatory framework adopted by the jurisdiction, rather than the size of the entity being regulated. Furthermore, comparisons between regulated entities need to be at the appropriate level where sufficient granularity makes comparisons meaningful. The use of hypothetical portfolios across jurisdictions could provide a meaningful measure of divergence. Regulatory colleges could be used to address the divergence in outcomes and assist with the harmonisation objective.

The risk based approach is constantly evolving and the object of more appropriately aligning capital to the risks taken by the bank should continue. Where appropriate, supplementary measures such as a benchmarking exercise could be undertaken.

Add: Question 4

Which of the potential ideas outlined in Section 5 offer the greatest potential benefit in terms of improving the balance between the simplicity, comparability and risk sensitivity of the capital adequacy framework?

Although not expressly identified as a potential idea, is global harmonisation of accounting standards. The introduction of a simple metric such as a leverage ratio can provide outcomes that are fundamentally divergent, given the starting point of the accounting treatment.

Simple metrics, although desirable, have the potential unintended consequence of diluting the understanding of the risk based approach that drives capital allocation. The global adoption of the Basel standards through the various approaches available provides the necessary platform for global comparison. An unintended consequence of simplification is that it provides a fall-back position that makes global harmonisation unattainable.

We believe that national discretion should not be used indiscriminately to mitigate against compliance with the international standards, however local conditions especially outside the advanced economies where the Basel framework was calibrated, may require a domestic solution. Regulators will be held to the Basel standards through peer reviews with a potential negative impact on sovereign ratings.

Although consolidation of the Basel framework has been proposed, many of its pronouncements are open to interpretation by the reader. We would like to propose that the Basel Committee facilitates an engagement with the banking sector, through the publication of an anonymised Q&A service that would provide a body of knowledge for bankers to draw on the underlying principles that give rise to the Basel framework as well as practical examples of how to interpret the framework.

Add: Question 5

Are there any other ideas and approaches that the Committee should consider?

The drafting of standards is dominated by experiences in the major jurisdictions. Consultation with regulators may be overshadowed by the dominance of these jurisdictions, resulting in proposals that do not take into consideration the particular circumstances of smaller jurisdictions.

It may be appropriate to consider a parallel process with emerging markets to ensure that adequate attention is given to the potential impediments to full compliance with the proposals. In this way an early intervention is possible and standards could be modified to take into account the absence of liquid markets, various developmental stages of economies and unintended consequences.

We believe that closer cooperation and coordination between the Basel Committee and other standard setting bodies as well as the FSB during this period could benefit the broader banking sector.

We hope that our comments have added value to your deliberations.

Should you require any further information, please do not hesitate to contact me.

Kind regards

General Manager
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