American Bankers Association
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Secretariat of the Basel Committee
on Banking Supervision (BCBS)
Bank for International Settlements
CH-4002 Basel, Switzerland

Re: Comments on the BCBS consultative document: *Identification and measurement of step-in risk*

Dear Basel Committee Members:

The American Bankers Association (ABA)[1] appreciates the opportunity to provide comment on the Basel Committee's (Committee) consultation, "Identification and Measurement of Step-in Risk" (Proposal). The Proposal seeks to establish a conceptual framework to measure potential support a bank may provide to an unconsolidated entity in the absence of any contractual obligation, and contemplates a regulatory capital requirement to address that risk. The Proposal is the Committee's response to the Financial Stability Board's request that it study the current scope of consolidation and mitigate the risks in banks' interactions with shadow banking entities.

We do not dispute the view that step-in risk is a matter for supervisory consideration. Neither do we believe that the Committee has made the case that a *global prudential regime* is necessary to address step-in risk. In the United States, accounting, legal, and regulatory reforms have already directly addressed step-in risk. Together with the effectiveness of those actions, banks have employed significant measures in connection with the risk so that today it remains a potential area of concern best and most effectively addressed via the supervisory process. We, therefore, believe a global capital standard is unnecessary, redundant, and potentially disruptive to existing supervisory programs, and we request that the Proposal be withdrawn. If individual authorities in other jurisdictions believe that step-in risk has not been appropriately addressed within their areas of responsibility, we encourage those authorities to explore local solutions.

The Scope of Presumed Step-In Risk in the Proposal is Overly Broad

The Committee describes step-in risk as the risk a bank would provide financial support to non-bank financial entities in times of market stress "beyond or in the absence of any contractual obligations."[2] The Proposal establishes a "primary indicator approach" to identify those relationships a bank may have with such entities that presume significant step-in risk exists. The indicator approach uses a broad definition of 'sponsor' reaching any and all sponsored fund relationships, without regard to whether history and/or market expectation indicates the likelihood of financial support is remote. Complicating matters, many of the indicators are inherently vague and difficult to operationalize in a coherent manner. For example, the highly expansive notion of sponsorship used in the conceptual framework, coupled with the strong presumption of risk in all primary indicators, leaves banks and supervisors with no practical measure to determine that the potential for step-in risk as defined has been properly addressed. This uncertainty is

[1] The American Bankers Association is the voice of the United States' $16 trillion banking industry, which is composed of small, regional, and large banks that together employ more than 2 million people, safeguard $12 trillion in deposits and extend more than $8 trillion in loans.
[2] Paragraph 2 of Step-In Proposal

further aggravated by an approach which does not permit banks to rely on contract law as a means of addressing supervisory concern regarding potentially unresolved step-in risk.

As a result of its overbroad approach, the Proposal, for example, overlooks many areas where tailored domestic reforms and regulatory mandates have mitigated the risk of a step-in event.

Domestic Regulatory Rules and Reforms Make the Proposal Unnecessary

Since the financial crisis, many domestic regulators and standard setters have developed additional regulatory and accounting measures that are aimed at addressing step-in risk. This is particularly true in the United States, where a broad global regulatory capital standard is unnecessary considering tailored U.S. laws and reforms. Consider the following, for example:

- Sections 23A and 23B of the Federal Reserve Act, as well as Regulation W, place quantitative limits on transactions with affiliates, such as between a bank and a sponsored investment fund.
- Supervisory tools that already capture step-in risk, for example the Comprehensive Capital Analysis and Review (CCAR),[3] Pillar 2, and interagency guidance on support of sponsored funds,[4] are key parts of the banking agencies supervisory process.
- The Securities and Exchange Commission has established rules to alleviate step-in risk at U.S. money market mutual funds. These rules minimize the run risk of money market mutual funds by, among other items, implementing a floating net asset value (NAV), as opposed to a stable $1 per share NAV, and imposing liquidity fees.[5]
- The Securities and Exchange Commission has proposed rules on liquidity risk management for mutual funds and exchange-traded funds that intends to support the ability of investors to redeem their shares in a timely manner.[6]
- The Financial Accounting Standards Board has revisited consolidation standards several times since the financial crisis, and consolidation accounting has been amended in a manner to reduce the likelihood of a bank stepping in to support unconsolidated entities.[7]

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[3] In the CCAR process, bank holding companies are required to identify and assess risks to their institutions, which assessment should include, "risks that only materialize or become apparent under stressful conditions."
[4] *Interagency Policy on Banks/Thrifts Providing Financial Support to Funds Advised by the Banking Organization*, January 5, 2004. Available at: http://www.federalreserve.gov/boarddocs/srletters/2004/sr0401.htm
[5] Securities and Exchange Commission, *Money Market Fund Reform; Amendments to Form PF*, 79 Fed. Reg. 157 (Aug. 14, 2014).
[6] Securities and Exchange Commission Proposal: *Open-End Fund Liquidity Risk Management Programs* 80 Fed. Reg. 62274 (October 15, 2015)
[7] *See* Financial Accounting Statements No. 166, Accounting for transfers of financial assets, and No 167, Amendments to FSB Interpretation No 46(R), issued by FASB. See also Accounting Standards Update 2015-02 *Amendments to the Consolidation Analysis*, February 2015.

- Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the so-called "Volcker Rule," includes prohibitions on banks providing support to covered funds, including hedge funds or private equity firms, where it directly or indirectly serves as an investment manager, investment advisor, or sponsor.[8]

Collectively these laws and reforms significantly reduce the ability—and therefore the risk—of banks to provide financial to support to non-bank financial entities. Additional reforms have been so significant that Federal Reserve Board Governor Daniel K. Tarullo, when discussing past instances of banks financially supporting off-balance sheet entities during the crisis, concluded that "[c]hanges in capital, accounting, and other regulatory standards make these arrangements very unlikely to reappear."[9]

The Basel Committee Proposal Should Be Withdrawn

The Basel Committee should not endorse the overly broad and prescriptive framework described in the Proposal and should withdraw the Proposal. National jurisdictions are already addressing step-in risk through rules tailored to their markets and banking industries. If individual jurisdictions believe that step-in risk has not been appropriately addressed domestically, we encourage those jurisdictions to explore local solutions. We do believe that the Basel Committee may serve a useful role in sharing information among domestic regulators and considering high level advisory principles about how domestic regulators might address view step-in risk.

If the Committee would like additional information regarding these comments, please contact Hugh Carney, at (202) 663-5324 (hcarney@aba.com).

Sincerely,

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[8] Dodd-Frank Act § 619. The Volcker Rule was implemented through a final rule jointly issued by U.S. regulators. Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation and Securities and Exchange Commission, *Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds,* 79 Fed. Reg. 5536 (Jan. 31, 2014). See also, 79 Fed. Reg. 5808 (Jan. 31, 2014).
[9] *Tarullo, Daniel K.*, Thinking Critically about Nonbank Financial Intermediation, Washington, D.C., November 17, 2015, p. 1 (http://www.federalreserve.gov/newsevents/speech/tarullo20151117a.htm).