



COMMENTS FROM THE ASSOCIATION OF SUPERVISORS OF BANKS OF THE AMERICAS (ASBA) TO THE CONSULTATIVE DOCUMENT

“Identification and Measurement of Step-in Risk”

(ISSUED BY THE BASEL COMMITTEE ON BANKING SUPERVISION FOR COMMENTS BY
17 March 2016)

I. Purpose of the revision

The Basel Committee on Banking Supervision (BCBS) is looking for comments on the proposed conceptual framework that aims to identify unconsolidated entities that could bring significant step-in risk for banks.

The document presents a set of indicators to identify the presence of step-in risk and a discussion of secondary indicators that could supplement those primary indicators, as well as potential approaches to reflect step-in risk in bank’s prudential measures, such as (i) the application of a conversion approach and; (ii) the regulatory consolidation of the identified entity.¹

Following are the comments made by the members of the Association of Supervisors of Banks of the Americas (ASBA) to the seven issues proposed by the BCBS.

II. Specific Comments

Q1. What are commenters’ views on the four overarching principles? Are there any others that should be included?

- The Association is of the opinion that the proposed Principles constitute a sound and a simple foundation for the development of a framework to account for step-in risk. However, the Association recommends adding language about the need to make sure that whatever framework is adopted it should be harmonized with the international standards.

Q2. What are commenters’ views on the proposed indicators for step-in risk? Are there any additional ones that the Committee should consider?

- Although the proposal indicates that the Committee will decide whether the step-in proposals will fall under Pillar 1 or Pillar 2; the Association suggests that at time of making the decision the Committee considers that the supervision of step-in risk should be conducted by improving the supervisory approach (Pillar 2) and not necessarily by setting capital charges.
- On *Indicator 10 - External credit rating based on a bank’s rating* - the proposal states that a rating agency takes into account the existence of a bank’s implicit support when

¹ Basel Committee on Banking Supervision. Identification and Measurement of Step-In Risk – Consultative Document. December 2015.



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assigning a score to such a bank, which should be considered as an indicator of step-in risk. This seems somewhat contradictory since ongoing financial reforms seek to limit the level of reliance on rating agencies.

- An additional indicator of “common ownership and common decision-makers” is recommended for inclusion. This indicator would deal with situations where banks are owned or managed by people who are involved with other unconsolidated or non-regulated entities. The same owners or managers may be involved in the decision-making process of those entities creating incentives for step-in risk.

Q3. What are commenters’ views on the proposed secondary indicators for step-in risk? Are there any additional ones that the Committee should consider? Should any of them be considered as primary indicators?

- The Association suggests classifying “Branding” and “IFRS 12” as primary indicators. A bank could share a brand with entities from different economic sectors or entities which could be unconsolidated and non-regulated entities; even if those are not part of the same economic group or common ownership. Furthermore, brand sharing is a strong channel for contagion due to market perception, so that a stress event can trigger step-in risk materialization.
- On the other hand, IFRS 12 refers to disclosure requirements of current intentions to provide financial support to non-consolidated entities. The fact that a bank defines its intentions to provide financial support if needed is the most direct indication that the support will be provided when necessary.

Q4. What are commenters’ views on the different potential step-in risk assessment approaches? Are there any other approaches that the Committee should consider to account for step-in risks?

The framework proposes three approaches to gauge the magnitude of step-in risk: full consolidation, proportionate consolidation and, conversion approach.

- The Association favors a full consolidation approach whenever possible, without prejudice to other requirements demanded by other regulators. The conceptual framework should, as far as possible, stick to the financial reporting so as to avoid separate procedures that result in additional information costs to institutions, regulators, and the entire financial system.



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- The proportionate consolidation approach is not fully effective because it does not capture all risks. The calculation of market risk, covariance, operational risk, hedging, liquidity and other risks, can be impaired when considering only the consolidation of a portion of the portfolio.
- It is important to consider that single row figure of the conversion approach may not encompass all the elements of a real situation. The exposure conversion (step-in) would follow an orientation which transforms all exposures of the non-consolidated entity into a single exposure (paragraph 71). The point is that this will not encompass all the risks involved, especially because this approach is suggested for entities that do not perform typical banking activities.
- The conversion approach appears to focus only on the risk of insolvency (capital). As interactions between banks and non-consolidated entities, in many cases of stress, include liquidity support, a requirement for additional liquidity in cases where there is a significant risk of financial support seems to be appropriate.

Q5. What are commenters’ views on the proposed mapping between the primary indicators and the potential approaches?

- As far as the conversion approach is concerned, it appears that Pillar 2 approach is more appropriate, given the complexity of this issue and the difficulty of translating the real situation into a single row figure. Also, as mentioned in Q2, the Association suggests keeping consistency on the lesser reliance on rating agencies, keeping them from being used as a primary indicator.

Q6. What are commenters’ views on proportionate consolidation for joint ventures?

- In some countries in the region, the prudential regulatory framework contemplates the proportional consolidation in the case of joint ventures. However, the logic of limiting the assessment of step-in risk only to contractual commitments does not seem appropriate, as reputational issues could generate incentives for one of the parties to provide financial support in an amount greater than necessary considering the limits of its contractual commitments.
- The presentation of joint ventures under the equivalent equity method provides a better view compared to proportionate consolidation. Also, to reduce the complexity of the statements of its controlling shareholders, the jointly controlled entity should also show its prudential statements.



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Q7. What are commenters’ views on risks stemming from banks’ relationships with asset management activities and funds and the appropriateness of the direction envisaged?

- A full consolidation approach seems to be excessive, which leads to a preference for using a conversion approach based on the sponsoring indicators. It is important to emphasize that the conversion approach for asset management and funds should not be limited to those given in paragraph 87 and has to consider, at least, all or part of the primary and secondary indicators described in Part 3.
- Considering the situation where there is a risk of a bank providing liquidity support to funds, the conversion measure should take into account the liquidity of the fund's assets about the potential amount redeemed.
- About the administration of funds, we believe that it is important to consider the risks of a bank (or the asset management held by a bank) since a bank can be held liable in court by investors of funds. This aspect tends to be more important in certain situations, such as funds:
 - With poor governance mechanisms, including the lack of robust regulations;
 - Those that have acquired bonds “out of the money” or bonds issued by companies with deteriorating ratings (which were not approved by the bank's lending policy).