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Switzerland Secretary General
Basel Committee on Banking Supervision
Bank for International Settlements
Basel
CH-4002
Attention: Mr William Coen

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Dear Mr Coen

Comment on the BCBS Consultative Document: Identification and measurement of step-in risk

We welcome the opportunity to comment on this initiative to address the interdependency of our banks with the shadow banking sector. It is important to note that the so called shadow banking sector in South Africa is regulated, and includes those important sectors identified in the Consultative Document of securitisation conduits, structured investment vehicles and money market funds.

The Financial Stability Board has, in taking direction from the G20, targeted the many independent actions that gave rise to the collective result of the global financial crisis. Standard setting bodies such as the BCBS have worked tirelessly to provide a rigorous framework that targets the weaknesses that were evident in some jurisdictions and we are supportive of these measures.

However, it has taken some time for the effects of the new standards to be felt on the financial markets and we are now seeing banks taking decisions to reshape their business, relook their risk reward assumptions and revalue their brand. As a result of the new standards we have seen a number of fundamental changes to global markets including a loss of correspondent banking relationships and heightened attention to corruption and money laundering resulting in closures of internationally active banks operations in certain jurisdictions.

The most recent event for South Africa is the announcement by Barclays PLC that they will be reducing their USD 3 billion stake in the Barclays Africa franchise to less than 20% to "*deconsolidate the Africa business and escape punitive capital charges*", which may be another example of a change in the way banks are reconsidering their business in light of the reforms proposed by the G20.

The BCBS has in this Consultative Document signalled that the practices of the banks providing support to the shadow banking sector, where they were neither contractually bound to do so nor held an ownership interest in the entity, should be stopped and such entities should rather fail, sends a clear message.

The regulatory burden of scientifically establishing the step-in risk of unconsolidated entities may be negated by a conscious decision to end this practice. We believe that prudential regulations should be designed around the actual step-in, rather than the establishment of prudential framework to anticipate what the step-in risk could be with a concurrent capital charge held for the risk, when in fact it may never occur.

Furthermore heightened corporate governance requirements would enable regulators to ensure that such decisions around step-in are taken at the highest levels within a bank. It would be difficult to prove that you have no intention to support an entity even if it was in a binding contract as it is precisely this ad-hoc behaviour outside of formal arrangements that gave rise to this proposed standard. It may be simpler to outlaw the practice unless there is approval from the banking supervisor or systemic risk regulator.

Add Q1: *What are commenters' views on the four overarching principles? Are there any others that should be included?*

We would urge the BCBS to consider introducing a framework that is punitive when step-in occurs, rather than a complex approach to anticipate a situation where step-in risk may occur. This we believe would be supported by principles 2 through 4.

For the remainder of our comments, we will address the questions without this proposal in mind.

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

We would suggest that the proposed indicators be simplified by combining some indicators within the sponsorship / influence categories and reducing the total number of primary indicators. For example, reducing the categories of partial sponsorship in indicators 2 to 5, reducing the categories of when decision making is required and where upfront facilities are required.

Generally, the reputational decision to step in should be based on sound business principles which would also consider the viability of the entity post the step in.

In respect of primary indicator 7 (Dominant influence with capital ties > 50%), it is unclear as to why this category would be included, as entities with capital ties >50% are already consolidated entities. In addition, in cases of full sponsorship, banks would already be holding capital against entities, suggesting that additional capital on top of this may be required.

It is further unclear as to the scope of "exclusive critical services providers" (primary indicator 11) and how a relationship with a critical services provider may indicate the risk of stepping in. More clarity is required on how 'highly costly' can be defined given that there is no legal obligation by a bank to step in. The threshold after which step in risk is deemed likely should be considered (is there a materiality level that would apply). We would welcome further clarification on this indicator.

Add 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?*

No further comment.

Add 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?*

We believe that the full consolidation approach is not an appropriate approach to measure step in risk, as the entity to which support is to be provided could already be consolidated by another banking group. With regards to the proportionate consolidation approach, banks may not have access to the information on some entities necessary to proceed with consolidation. The conversion approach is therefore deemed to be the most plausible approach.

Add Q5: *What are commenters' views on the proposed mapping between the primary indicators and the potential approaches?*

Our view is that the consolidation approach (both full and proportional) is not an appropriate measure, and thus the conversion approach should be utilised to reflect step in risk, as this is the most simplified approach. As a result, this should be taken into consideration in the proposed mapping of indicators to their respective measure.

Add Q6: *What are commenters' views on proportionate consolidation for joint-ventures?*

No further comment.

Add Q7: *What are commenters' views on risks stemming from banks' relationships with asset management activities and funds and the appropriateness of the direction envisaged?*

We believe that where capital is not already held in respect of asset management entities, i.e. from guarantees required to meet a shortfall in the fund's returns, applying a conversion approach to the assets under management is the most appropriate measure. We would also like to highlight that asset managers are compelled to spread their risk and as such step in risk should be limited when applying a conversion approach to assets under management. In addition, a one size approach doesn't fit all as the level of risk would differ under different types of funds.

In concluding, we hope that our comments will assist the Basel Committee on Banking Supervision in their deliberations and remain available to the Committee should further information or clarity be required.

Assuring you of our best attention at all times.

Yours sincerely

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Mark Brits
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