EBF_046516
7 June 2024

EBF RESPONSE TO BCBS CONSULTATIVE DOCUMENT ON THE REVISION OF THE ASSESSMENT FRAMEWORK FOR GLOBAL SYSTEMICALLY IMPORTANT BANKS

The European Banking Federation[1] (EBF) welcomes the opportunity to put forward our comments on the Basel Committee on Banking Supervision (BCBS) Consultative Document (CD). The EBF response to the consultation represents the consolidated view from all global systemically important banks (G-SIBs) and non-G-SIBs in the assessment sample under the EBF umbrella given that the scope of any extension of the reporting impacts not only G-SIBs but also banks in the sample and the additional sample even if their score is less than 130 basis points.

We hope our comments are useful in your assessment of the revision of the framework and remain at your full disposal to clarify and/or provide further details on any comment. We further stand ready to engage in a dialogue towards finding a suitable framework that is feasible for both, BCBS and G-SIBs (and non-G-SIBs in the assessment sample).

Background

Current assessment methodology for G-SIBs has been published in July 2013. This methodology is based on a set of indicators and a final score having the aim to identify the banks which will be subject to higher capital requirements. These indicators are based of *Stock* and *Flow* indicators, which measure the overall significance of a bank activity in relation with all the others in the industry. *Stock* indicators are reported as of financial year-end, while the *Flow* indicators are reported as the cumulative activity over the reporting year.

The aim of the CD is to revise the overall framework in order to take in consideration, for *Stock* indicators, measures with a higher frequency. This approach has been taken in consideration in order to avoid window-dressing incentives to the involved banks in reporting for the adjustments of the indicators.

Findings of presumed window-dressing behavior is described in the accompanying Working Paper (WP) 42[2] which has been published together with the CD. The variables taken in consideration within the working paper that contribute to G-SIB scores are the OTC derivatives and Repos.

Working paper findings and relation with G-SIB indicators

The WP focused its analysis on OTC derivative and Repos data for the last 10 years, related to 70 global banks in 16 jurisdictions as collected within the Quantitative Impact Study. Within the WP is observed a contraction in overall amount of OTC derivatives and Repos at the year-end quarters the other quarter-end data. This contraction is linked, in the WP, to a specific bank behavior in order to decrease the overall size of its activity for the G-SIB assessment purpose and concludes that the main part of these variations would be explained by window-dressing without a rationale quantifying the part of the variation that could be

[1] The EBF is the voice of the European banking sector, uniting 33 national banking association in Europe that represent some 3,500 banks – large and small, wholesale and retail, local and international – employing about 2,7 million people.
[2] "The G-SIB framework incentivises window-dressing behaviour: causal evidence from a quantitative impact study", *BCBS Working Papers*, no 42, March 2024, www.bis.org/bcbs/publ/wp42.htm

associated to each cause (market practices, regulatory requirements for compression and window dressing).

The WP works over the basis that all year-end variations are stemming from window dressing behaviour without quantifying the other two main drivers:

1) seasonal reduction of positions at year-end e.g., HF/Assets Managers reducing their positions, and

2) pricing adjustment due to specific year-end costs.

Furthermore, OTC derivatives are mostly long-term transactions used to manage interest rate risk and cannot be subject to window-dressing by nature.

The revised framework extends the measures to the whole scope of indicators of the G-SIB framework without clear evidence of window dressing on any of the items of the score.

Since we observe that no other explanation was considered to assess and explain the decreases which we consider impact the reliability of the conclusions in the WP, we offer our readiness to engage in an open dialogue to explain further the other factors and their weights.

Factually, it is just to observe that, within the G-SIB indicators, the OTC derivatives are taken in consideration within the *"Complexity"* Category, with 2 other indicators (*"Level 3 Assets" and "Trading and Available for sale securities"*). Complexity weights for the 20% of the overall G-SIB score. Thus, OTC derivatives impact for the 6.7% of the overall G-SIB score but are also accounted for in other items of the G-SIB score as illustrated below.

Repos are not considered as a single G-SIB indicator and are included within the overall *"Total exposure"* as defined for the Leverage ratio. The *"Total exposure"* indicator is a standalone category, with a weight of 20% of the overall G-SIB score. Repos are also accounted for in several other items of the G-SIB score.

Based on the weights associated to the G-SIB categories, we can estimate an overall impact on the G-SIB score of a 15% decrease on the volumes of Repos and OTC derivates (based on Chart 4 of the WP):

		Relative weight				
GSIB indicators	**Weights**	Repos (weight repos on Total * weight of the indicator)	OTC derivatives (weight of OTC deriv. on Total * weight of the indicator)	Total weight (repos/derivatives on GSIB score)	WD maximum potential impact (based on the 15% of WD Ref. in WP42)	WD maximum potential impact on a GSIB with a 300 pts score
Size	20%	1,87%	1,04%			
IFA	6,67%	0,31%	0,70%			
IFL	6,67%	0,87%	0,75%			
OTC Derivatives	6,67%	N/A	6,67%	15,59%	2,34%	7,0
level 3	6,67%	0,52%	1,08%			
CJC	10%	0,00%	0,32%			
CJL *	10%	0,69%	0,77%			
* Impact of repos on CJL and L3 : not assessed on full sample		4,26%	11,34%			

(Study based on a sample of 4 representative G-SIBs from different EU jurisdictions)

As a way of example, considering a G-SIB with a 300pts G-SIB score, the overall impact of such a year-end decrease would be around 2% (7 pts). This impact is quite limited and, in our view, does not justify the substantial burden induced by the envisaged revision proposed in the consultation.

Accordingly, we consider further analysis involving proper engagement with the industry is necessary to reach to robust conclusions. It is our view that the current analysis presented in the BCBS' WP is not yet conclusive to determine that a) there is evidence of window-dressing behaviour, and b) this provides a rationale for the BCBS proposal to change the data frequency requirements in relation to the wider G-SIB indicator set. We further consider that the BCBS should conduct further analysis and dialogues around the impact of other factors that may account for market data volatility, such as reduced end-year market trading and client balance-sheet management (particularly in the context of notional compression cycles). We further note that these factors would potentially apply across the wider set of banking entities, beyond those designated as G-SIBs.

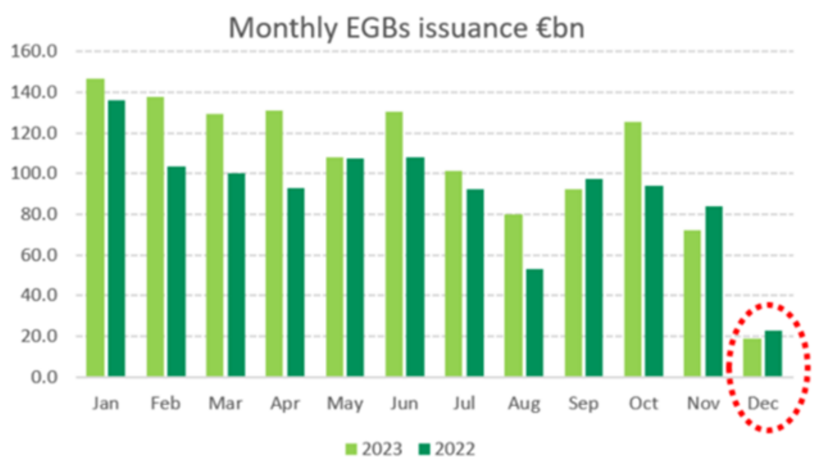
A few examples that we consider should have been considered and quantified:

- Repo

  The reduction of repo volumes toward year-end is explained by two key drivers:

  (i) Counterparties reduce their risk by year-end (some securities lenders recall bonds they have lent during the year and investors tend to reduce their exposure at year end as liquidity decreases).

  (ii) Reduction in interbank market is not specific to repos. Indeed (Figure 1), volumes in secondary French and German government bonds are also lower at year-end and (Figure 2) European Bonds Issuance (in Eurozone, GE, FR, SP and IT being the biggest contributors) in which December activity clearly reduce while repo are correlated to such activity.



Sources: National treasuries

Pricing and profitability should also be taken into consideration: Indeed, the prices are higher in December due to specific B/S year-end costs. Most repos are short-term transactions, this leads to adjusted prices to maintain their economic profitability over year-end which in turn reduces clients' demand. Certain counterparties are able to maintain their positions thanks to increased netting (e.g., better matching by counterparty and maturity date) while other elect to temporarily close their trades. Hence, the BCBS' WP graph 1a (Europe) only show net exposure for repos (size indicator in G-SIB) while the same graph measured in terms of gross repos would have shown less variability.

- Derivatives

  BCBS' WP Graph 1a (Europe) does not demonstrate any clear evidence of window-dressing for OTC Derivatives. As explained previously for repos, reduction at year-end is mainly explained by less market activity driven by reduction of risk from financial counterparties. In addition, OTC Derivatives notional are mostly made of interest rate transactions (e.g., IRS) which are by nature long-term transactions so cannot be reduced by year-end.

  Furthermore, banks must perform multilateral compression cycles on a regular basis with external providers (e.g., TriOptima) to reduce notional by terminating trades while keeping risks within tolerances agreed with participants. These portfolio compressions permit to reduce operational risk (e.g., managing too many cash flow payments) and are required under EMIR regulation . Compression cycles are not related to window-dressing. These are mandatory for significant players. It allows to limit the level of risk for which banks cannot be responsibilized for doing this also at year end.

  As previously stressed, we stand ready to engage in an open dialogue towards better understanding and jointly assessing the impact of external factors that would help to focus on any potential real window dressing.

Usage of G-SIB indicators in financial institutions internal managerial purposes

Starting from the results of the WP in relation with the OTC derivatives and Repos, the CD's main aim is the evaluation of higher frequency indicators rather than the current year-end based approach. This evaluation is made for all 10 stock indicators, not only the ones analyzed in the WP. The proposed frequency is quarterly, monthly and daily.

A quarterly frequency does not represent a specific additional burden for the industry for two reasons: 1) quarterly reporting is already in place in EU as of EBA requirements for Global Systemically Important Institutions (G-SIIs), which guidelines follow closely the Basel Committee recommendations and efforts to identify G-SIBs and provides data which contribute to assess EU banks' systemic riskiness; and 2) the production of quarterly indicators by the involved banks is performed within the quarterly accounting and reporting process, with all the consistency checks and analysis for the production of data of the highest quality.

In fact, the indicators used in the G-SIB score computation are based on the current quarterly reporting framework– mainly Common Reporting (COREP) and Financial Reporting (FINREP) by the European Banking Authority (EBA). It allows the G-SIB score to be calculated using data subject to a strict data quality process associated to the quarterly accounting production leading to a high-level of reliability and comparability. The requested information is not available on a monthly or daily basis.

The production of all indicators with a monthly frequency represents a very significant burden for the industry. The main reason is due to the need of an accounting and reporting process which have almost the same extent of the quarterly one to produce data and indicators with an overall quality comparable with the quarterly one. Within some banks a simplified reporting process for managerial purposed could already be in place, which produce some, but not all, of the data used as G-SIB indicators. As such, these monthly simplified processes (for banks which have implemented them) are far from having the breadth and scope of the quarterly process and, thus, no robust conclusions could be drawn based on indicators produced within this framework. In fact, it would be difficult to differentiate actual variations from discrepancies induced by data quality issues.

In this context, it appears that using month-end averages would not be feasible as it would require to roll out a monthly accounting production process to ensure the data quality and the consistency with other reporting requirements. Such process would lead to unbearable costs for the institutions.

The production of daily average G-SIB indicators is, from a practical point of view, an unfeasible task. Most of G-SIB indicators are based on accounting measures and evaluation, which are not calculated on a daily basis. Banks' business is managed on a daily basis leveraging on other data and indicators, which does not have any contact with indicators and measures used for accounting and G-SIB purposes.

Moreover, it should be observed that many of the G-SIB indicators do not have the intrinsic variable nature like the OTC derivatives and Repos. Some of them are out of control of the banks due to nature of the indicator i.e., the Assets under Custody held on behalf of the banks customers).

In addition, the burden and the operational cost for increasing to daily or monthly averaging figures for international banking groups operating in different/several jurisdictions in a subsidiary structure would be disproportionate to the potential benefit.

Accordingly, we consider that moving from year-end data to quarterly data would be sufficient to monitor any potential window dressing behavior. We further consider that a balance between a more granular approach and not to overburden institutions should be the objective.

It is thus our view that the only frequency that can be envisaged to ensure the robustness and the accuracy of the G-SIB score computation and avoid significantly high operational costs for institutions would be an average over quarter-end values.

Availability for NCAs of higher frequency indicators and data

In last 10 years the size and frequency of the data provided by banks for supervisory and statistical purposes to NCAs and supervisors has considerably increased. In this context, supervisors can request ad-hoc data collection at different frequencies to investigate on these practices if need be.

There are many data and information already in the availability of the supervisors since many years with established processes and methodologies with quarterly[3], monthly[4] frequency, both at national and EU level. However, we would underline that reports produced with monthly frequency are not subject to the same data processing cycle than the quarterly reports (assuring assurance of highest data quality) and that while superficially similar to some of the G-SIB items, there are critical differences which mean they are not

[3] EBA Reporting frameworks are the main supervisory data structure with a quarterly frequency.
[4] Balance sheet item (BSI) reporting framework is reported monthly on an individual basis to ECB.

identical (hence would require still significant infrastructure change/ investment to align with the G-SIB data items).

Conclusions

NCAs and EU supervisors have since many years the possibility to investigate and analyze the movements in banks' balance sheets leveraging on high quality data, submitted on a robust and extensive reporting framework based on the nature of the specific area to be monitored and assessed. Accordingly, it should not be considered as probable that banks could hide the size of the financial stocks and flows managed within their normal financial business since all relevant data are known by national and EU authorities. Supervisors can, in this context, rely on ad-hoc data collection at different frequencies to investigate on these practices if need be. In addition, supervisors have the power to move a G-SIB to a higher bucket (or to keep an institution in the list), it has been done several times in Europe. Either window dressing was taken into account, or it was proved not to be done but, in any case, it must have been considered.

In case more frequent data should have to be provided, we consider that quarterly averaging should be the right-balance alternative to current end-year point-in-time values, backed up with supervisory ad-hoc requests to specific institution where a potential window dressing behavior is observed. These ad-hoc requests should include pre-defined parameters and only be applied to the data where there is reasonable suspicion and not for all indicators of the G-SIB assessment.

This approach would increase the available data for BCBS avoiding that non-suspicious entities are overburdened by the window dressing behavior of the other entities.

Since some years already, the EBF is currently working with supervisors and authorities on ways to improve the efficiency of reporting in Europe having as a basis the EBF guiding principles launched in 2018[5]. These principles are the industry's vision for integrated data reporting based on 'defined once', 'reported once', and 'share information'. The latter relates for authorities to share data among themselves in order to minimise the reporting burden for banks. In the context of the BCBS' CD, we are convinced that a proper sharing of data already available between authorities could permit the proper fine tuning of the G-SIB assessment methodology using data submitted with a frequency aligned with the business nature of the indicator itself.

Currently the G-SIB reporting and related scoring is based on year-end data. Quarterly data for all indicators, based on a robust process aligned with the accounting and supervisory one, are already available to all involved authorities. The shift to quarter-end averages would permit an increase of the overall assessment methodology. The higher monthly frequency however would tremendously increase the operational burden for banks, with potential decrease in overall quality of the reported data due to the misalignment with the quarterly accounting reporting process, without providing any significant additional information compared with the quarterly frequency. To ensure a satisfactory data quality level and consistency with accounting and supervisory production, institutions would have to implement a monthly accounting production like process. Once again, such a process would lead to unbearable costs for the institutions.

Furthermore, the daily frequency for G-SIB indicators does not have any business meaning. Data could not be produced with an acceptable level of quality compared with the official

[5] https://www.ebf.eu/ebf-media-centre/data-reporting-european-banks-underline-need-for-an-integrated-and-standardized-eu-framework/

reporting process. In fact, the analysis and conclusions derived from data calculated on a daily basis may produce wrong assumptions and conclusions.

As previously noted, the burden and the operational cost for increasing to daily or monthly averaging figures for international banking groups operating in different/several jurisdictions in a subsidiary structure would be disproportionate to the potential benefit. Also, we consider that moving from year-end data to quarterly data would be sufficient to monitor any potential window dressing behavior while aiming for a balance between a more granular approach and not to overburden institutions.

To this end, we reiterate our eagerness to work together with the BCBS towards determining the best approach that can reassure authorities that window dressing behaviour is not taking place while not overburdening institutions with impractical and costly requirements.

***