RESPONSE TO THE BASEL COMMITTEE´S REQUEST FOR COMMENTS ON THE CONSULTATIVE DOCUMENT *"GLOBAL SYSTEMICALLY IMPORTANT BANKS - REVISED ASSESSMENT FRAMEWORK"*

Buenos Aires, 30th June 2017

Secretariat of the Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel, Switzerland

Ref.: Consultative Document "Global Systemically Important Banks"- Fit & Proper´s comments

Dear Committee Members,

We are pleased to submit the following Fit & Proper´s comments and suggestions in response to the Consultative Document "*Global Systemically Important Banks - Revised Assessment Framework"*, issued by the Basel Committee on Banking Supervision (BCBS) on March 2017.

Fit & Proper LLC provides advisory and consulting services on issues related to banking supervision and regulation, central banking, financial institutions and financial inclusion and microfinance, among others. On this regard, Fit & Proper provides services to banking supervisors, central banks, deposit insurance agencies, ministries of finance and multilateral organizations, including the Interamerican Development Bank, the International Monetary Fund, and the World Bank. Fit & Proper and its consultants have experience in more than 30 countries. You can find further information in www.fitproper.com.

These comments were prepared by Javier Bolzico, Marcelo Zárate, and Natalia Teplitz.

We would like to express our appreciation to the BCBS for the opportunity to provide feedback on this Consultative Document.

Furthermore, we would like to take the opportunity to congratulate the BCBS for the good job that they are carrying on regarding the Global Systemically Important Banks Assessment Framework. We believe that it will be an important instrument to guide supervisors, contributing to the financial stability.

We would be pleased to provide more information or further discussion on any of these issues. If you have any comments or questions, please feel free to contact us at info@fitproper.com.

Yours faithfully,

Javier Bolzico
CEO - Fit & Proper LLC
jbolzico@fitproper.com

Natalia Teplitz
Manager - Fit & Proper LLC
nteplitz@fitproper.com

Comments / suggestions on Consultative Document *"Global Systemically Important Banks - Revised Assessment Framework"*

Q1. What are respondents' views on each of the proposed changes in the G-SIB assessment methodology?

In general, we consider the proposed amendments are appropriate in order to strengthen the G-SIB assessment methodology by introducing new dimensions of systemic risk, and maintain consistency with the broader Basel framework.

We have the following general comments to the G-SIB assessment methodology.

1. Equal weights

The methodology for identification of G-SIBs assesses the relative systemic importance of a large sample of internationally active banks on an annual basis via an approach based on 12 indicators in five categories (cross-jurisdictional activity, size, interconnectedness, substitutability, complexity), that describe a bank's systemic importance from different distinct dimensions.

The methodology gives equal weight for each of the five categories used to compute systemic importance. Even though this approach has the advantages of being simple, homogeneous and comparable, it may underestimate the systemic impact of banks. If, for instance, one or two categories are not relevant for a determined bank, it may make the bank appear to be less risky while, in reality, it may be of significant importance. A more suitable methodology may be one that gives more weight to the categories that better indicate the systemic importance in each case.

On this regard, ***we suggest that the methodology comprises, in addition to the fixed weights, the possibility that each jurisdiction modifies the weights as considered convenient***.

One example of a different weighting is the entropy-based method proposed in a quantitative analysis made for the Chinese banking system, which emphasizes the different role that each indicator plays in distinguishing banks. The designed weighting method puts more weights on the indicators in which the samples distribute more dispersedly, meaning that if the indicator is better to differentiate the banks it should have more weight. Also, this weighting method ensures weight update every year, capturing the changing importance of the indicators.[1] Other example is a study of the Board of Governors of the Federal Reserve System, which analyzes three alternative weighting schemes: the first estimates weights that parsimoniously span the information provided by the indicators; the second alternative weighting scheme is

[1] Chen, Y., Shi, Y., Wei, X., & Zhang, L. (2014). Domestic systemically important banks: a quantitative analysis for the Chinese banking system. Mathematical Problems in Engineering, 2014.

F&P, USA
8750 NW 36 Street, Suite 425, Miami, FL33178USA
www.fitproper.com

based on a market-based measure of systemic losses given default; and the third invokes economic theory describing how the distribution of firms within an industry reflects underlying competitive conditions.[2]

2. Indicator of recovery and resolvability

We suggest analyzing the convenience and viability of introducing an additional indicator for the identification of G-SIBs related to the bank´s recovery and resolvability strategy. The argument is that a bank with a credible and coherent recovery and resolution plan (as recommended by the "Key Attributes of Effective Resolution Regimes for Financial Institutions")[3] is less likely to pose a systemic threat to the financial stability.

Q2. What are respondents' views on potentially including STWF as an indicator in the interconnectedness category?

We consider that the inclusion of short-term wholesale funding (STWF) as an indicator in the interconnectedness category may be a suitable element to reduce G-SIBs incentives to rely on STWF, as it proved to exacerbate system-wide losses and be a significant source of financial instability. However, it is not clear that STWF by itself is of systemic nature; small institutions can be very reliant on short-term funding. Therefore, this topic requires more analysis.

In the United States, the Federal Reserve has already incorporated a STWF indicator in its G-SIB´s methodology, by introducing an alternative method that includes a STWF category instead of the substitutability category. Under this method, banks that are more heavily reliant on STWF get a higher indicator of systemic importance and, thus, are required a larger risk-based capital surcharge. This methodology has received critics from the industry for imposing more severe capital surcharges. However, the BCBS proposal differs from the Federal Reserve methodology, by giving less weight to the STWF indicator.[4] Furthermore, this proposal seems to generate almost no change to the current G-SIB scores according to the quantitative analysis included in the document.

In summary, ***we consider that the inclusion of STWF as an indicator for the identification of G-SIBs may be appropriate, but this issue requires further analysis.***

[2] Passmore, Wayne, and Alexander H. von Hafften (2017). "Are Basel's Capital Surcharges for Global Systemically Important Banks Too Small?," Finance and Economics Discussion Series 2017-021. Washington: Board of Governors of the Federal Reserve System.

[3] Financial Stability Board (2014). Key Attributes of Effective Resolution Regimes for Financial Institutions. October 2014.

[4] The BCBS approach introduces the STWF as one of the four indicators of the interconnectedness category, while the Federal Reserve methodology replaces the whole interconnectedness category.

F&P, USA
8750 NW 36 Street, Suite 425, Miami, FL33178USA
www.fitproper.com