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The Director General delegate

Paris, August 24th 2011

French Banking Federation comments on the BCBS Consultative Document on "Global systemically important banks: assessment methodology and the additional loss absorbency requirement"

Dear Sir,

The French Banking Federation (FBF) represents the interests of the banking industry in France. Its membership is composed of all credit institutions authorized as banks and doing business in France, i.e. more than 500 commercial, cooperative and mutual banks. FBF member banks have more than 25,500 permanent branches in France. They employ 500,000 people in France and around the world, and service 48 million customers.

The FBF welcomes the opportunity to share with the Basel Committee (BCBS) the views of the French banking sector on the proposal for an assessment methodology and the additional loss absorbency requirement for global systemically important banks (G-SIBs). The FBF supports the efforts to establish rules ensuring more financial stability and is very keen to contribute to the debate.

We support the initiative of this consultation document and the objective of reducing the probability of G-SIB failure. However, giving the importance of the subject, it would have been preferable to provide for a longer consultation period especially as it lasted hardly one month in the middle of the summer.

The consensus view of the French banking industry is that the concept of SIFI surcharge is misguided, will not enhance more financial stability, and will have detrimental economic implications.
In addition, French banks contest the arbitrary nature of the methodology and of the level of the surcharge, the lack of transparency regarding the sample of 73 selected banks and the cut-off point between the 27th and the 28th banks.

Mr Stephan WALTER
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The main points the FBF develops in the response are as follows:

- A SIFI capital surcharge is an inappropriate response to the problem as systemic risk is a complex and multi-faceted phenomenon whose channels of propagation can take a wide variety of forms, as the recent crisis developments have demonstrated. The proposed surcharge will not decrease the probability of default for firms badly managed and supervised inadequately, nor it will limit the domino's effect due to interconnections within the financial world.
- The existing intensive regulatory agenda aimed at reducing the probability and the impact of failures should be taken into account, before adding new features aimed at the same goal. The significant economic impact of these regulatory reforms would be further aggravated by a SIFI surcharge.

If nevertheless, the BCBS decides to develop this approach, it must be kept in mind key principles governing the design of the future regulation:

- The level playing field between all financial institutions should be maintained, globally, regionally and nationally. It should be noted that the more complex the new regulatory framework will be, the more difficult it will be to apply an effective supervision and the more there will be an incentive for regulatory arbitrage towards the shadow banking system and towards other international jurisdictions.
- Classifying banks as SIFIs on the basis of 5 indicators broadly defined and highly correlated with size, carries important risks. Any methodology and indicators must be tested and debated in order to be as objective and transparent as possible. The conditions of G SIFIs 'list revisions have to be précised.
- The EU internal market should be regarded as a single domestic jurisdiction, especially in terms of interconnectedness across borders inside the EU.
- G SIFIs 'surcharges must be determined only at the consolidated group level.
- It must be clearly stated that pillar 2 needs to be adapted to accommodate the existence of these additional loss absorbency requirements for G SIFIs.
- The debate on instruments to meet additional loss absorbency requirements should be pursued and contingent capital should be admitted as an alternative to common equity tier 1.

To summarize our position, French Banking Federation thinks that the proposed surcharge for G SIFIs is not an appropriate answer to the real issue of systemic risk. It does not address the problem of interconnectedness on financial markets and the role of the shadow banking system which were the major triggers of the crisis development. By adding a new layer on top of the recent Basel new requirements, it will hamper the capacity of major banks to finance the economy and constitute a huge incentive for conservative banks' management to take on board more risks to match the returns of less prudent institutions.

You will find in the annex attached our general comments and our concern for the issues raised in the consultative document.

We thank you for your consideration and remain at your disposal for any questions or additional information you might have.

Yours sincerely,

Pierre de Lauzun

Annex : Comments on Consultative Document - Global systemically important banks: Assessment methodology and the additional absorbency loss requirement

1) **General remarks**
2) **Level playing field issues**
3) **EU internal market as a single domestic jurisdiction**
4) **Methodology and classification of SIFI – List and periodic review**
5) **Group treatment and powers of home regulator**
6) **Interaction with Pillar II (§67 et 94-95)**
7) **Instruments to meet the additional loss absorbency requirement**

1) General remarks

Since the last financial crisis, many regulatory changes (Basel III, RRP) have been introduced to ensure financial stability. The impact of those regulatory reforms should be further assessed.
The more complex the new regulatory framework will be – adding different charges and surcharges at the national, regional and global level – the more difficult it will be to apply an effective supervision and the more there will be an incentive for regulatory arbitrage towards the shadow banking system and towards more lenient jurisdictions.
It would be wise to take time to observe the effect of other reforms before finally determining the need for a SIFI surcharge, which may be disproportionate or may distort competition.

We believe a SIFI capital surcharge is not the appropriate way to address systemic risk. Indeed it may appear counterproductive and does not prevent a bank from failing. Capital surcharge is only a way of discouraging acquisitions and engaging in more and more activities.
A better approach than focusing on surcharge is to take into account
- - the development of a SIFI resolution regime which is in process
- - the qualitative aspects such as process of internal control and measures adopted by institutions to mitigate risks

Therefore, attention should be concentrated on the following priorities:
- keep on enhancing risk-focused approaches
- develop efficient orderly recovery and resolution process
- develop an efficient macro-prudential regulation, focused on the real system consolidated risks

If anyway an additional loss absorbing capacity is introduced for G-SIBs, utmost care should be taken to make the framework as reasonable as possible.
Flexibility should be sought as regards the instruments to meet the additional loss absorbency requirement. Indeed, the paper is very restrictive and allow only CET 1 to meet the additional loss absorbency requirement. We share BCBS' opinion for further study on this subject and strongly support the use of contingent capital or other loss absorbing instruments to meet national loss absorbency requirements.

2) Level playing field issues

The level playing field between all financial institutions should be kept in mind, globally, regionally and nationally.
Systemic risk is a dynamic concept, which may arise from a variety of situations and institutions, as the crisis has shown. This means that the list of systemic institutions should be very large, the scope should be broadened, and different types of financial institutions should be included. The paper does not examine the role of other financial and non-financial institutions. We are aware that BCBS is only in charge of banking issues. However, it is essential to make sure equivalent requirements are being developed in other sectors (insurance, market infrastructures, payments systems, hedge funds, etc...)
The relation between global and national surcharges should be carefully considered to ensure consistency. In fact, in certain countries there might be two major banks. If only one is classified as G-SIB and the other is not, there will be competition distortion. To that end, a local SIFI regulation may be necessary and well articulated with G-SIB provisions.
The BCBS consultative document acknowledges that the share of lending to the non-financial private sector that could be impacted by the proposed regulation ranges from 4% to about 75% which will undoubtedly lead to distortions of competition between countries.
The FBF is also concerned about how this proposal will fit to the US regulation. Indeed, section 165 of Dodd-Frank Act requires the Federal Reserve to adopt rules subjecting US bank holding companies with more than $50 billion in total consolidated assets to « more stringent » capital requirements. The criteria for capital surcharge are not the same than those used by the BCBS. So it is important to ensure that there will be a full harmonization between different countries and within countries.

3) EU internal market as a single domestic jurisdiction

As a matter of principle, the European Union must be seen as a single domestic jurisdiction, especially in terms of interconnectedness across borders inside the EU. This should be considered, particularly, in the factor of cross-jurisdictional activity.
It would go against the spirit of European integration if banks were treated less favourably on the sole ground of doing domestic retail banking in different EU Member States.

4) Methodology and classification of SIFI - List and periodic review

Any methodology and indicators to assess systemic relevance must be thoroughly tested and debated to be as objective and transparent as possible.

- Data issues

The consultative document acknowledges that the data used to construct the indicator-based measurement approach may not be currently sufficiently reliable or complete. The Basel Committee is committed to fully address any outstanding data quality issues before the implementation date (para 71). We support the Basel Committee's efforts to address the data quality issues identified. It is important to ensure that a common international framework for reporting the data that feeds into the G-SIB calculation would be in place before implementing the proposal. In doing so, the nature of the impact of the differences and changes in accounting standards on the measurement of indicators should be identified and taken into account.

- Indicators and Methodology

Many indicators seem to be highly correlated with size. So there is a risk of multiple counting for banks whose market share is important in several activities.
In addition the fact that systemic importance is treated as a relative concept leaves a lot of uncertainty as to how banks' actions can affect the surcharge that would be applied to them.

Therefore the proposed methodology does not provide a clear set of incentives to firms to organize the reduction of systemic importance. The methodology should be redesigned such that banks' actions directly affect the level of their surcharges through the use of absolute rather than relative measures of systemic importance.

- Bucketing approach

The list of systemic institutions should, at least include all the banking systems of G20 countries. Using the measures used in the Dodd-Frank Act, it has been estimated that at least 140 banks within the G20 area could be classified as SIFIs.

- Periodic review

The Proposal provides that individual G-SIB systemic importance scores will be updated annually based on changes in the bank indicator amounts, and that the cut-off score and the threshold scores for the surcharge buckets will be initially fixed for three to five years and then reviewed. Given that the calibrations were based on current estimates and judgments regarding the probability of default and the costs of such default, a reduction in these key variables in the aggregate should result in a reduced capital surcharge.
Besides, there should be periodic review of the bucketing approach (the sample of banks) BCBS should consider widening or reducing the sample depending on the evolution of the global level of systemic risk. Otherwise, there will be no incentive for banks to improve their management to reduce their systemic risk.

5) Group treatment and powers of home regulator

As mentioned in the consultation « The assessment of the systemic importance of G-SIBs is made using data that relate to the consolidated group. To be consistent with this approach, the Basel Committee proposes to apply the additional loss absorbency requirement to the consolidated group. »
We insist on the fact that the surcharge should only be required at the consolidated level. The possibility of letting host supervisors to apply additional requirements at the individual legal entity would only complicate the implementation and end up giving rise to inconsistencies at the international level.

The BCBS explicitly allows (footnote 16) local supervisors to impose higher surcharges in case there is no credible Recovery and Resolution Plans. The reverse should also be possible: a credible RRP should be used to set off and reduce the capital surcharge as it is a clear mitigating factor impacting directly on the complexity and substitutability areas, thus reducing the negative externalities caused by a failure of a G-SIB. However, it is important that clear, objective and transparent criteria be used to assess both jurisdictions and firms recovery and resolution arrangements. Only once such criteria are in place, recoverability and resolvability could be included in assessing systemic surcharge.

6) Interaction with Pillar II

The BCBS consultative document acknowledges that the additional loss absorbency requirement can be considered close to Pillar 1. There should not be multiple additional capital surcharges and we agree with the Committee that Pillar 2 needs to adapt to accommodate the existence of additional loss absorbency requirements for G-SIBs.

7) Instruments to meet the additional loss absorbency requirement

The consultation lists a set of pros and cons of going-concern contingent capital and arbitrarily concludes that the capital surcharge will be met only with CET1. We think the decision is quite hasty and the BCBS should not rule out this option. There is a need for further and thorough study.

As a conclusion, the FBF believe that a capital surcharge is premature particularly because the effects of the new Basel III framework have not been fully assessed yet. Besides other regulatory changes are underway such as recovery and resolution plan whose final objectives are the same as those wanted by BCBS when establishing a capital surcharge.
BCBS should observe the effects and interaction of these new standards before demanding a new capital surcharge to G-SIBs