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FBF comments on Basel Committee's Consultative Document: "Global systemically important banks – revised assessment framework".

General comments

The French Banking Federation (FBF) represents the interests of the banking industry in France. Its membership is composed of all credit institutions authorised as banks and doing business in France, i.e. more than 340 commercial, cooperative, and mutual banks. FBF member banks have more than 38,000 permanent branches in France. They employ 340,000 people in France and around the world and serve 48 million customers.

The French Banking Federation (FBF) welcomes the opportunity to comment on the Basel Committee's Consultative Document: "Global systemically important banks – revised assessment framework.

We understand that the Basel Committee aims to address perceived window-dressing behaviour that aim to lower banks' GSIB capital requirements at year-end. **However, we have serious concern on the rational of the conclusions and on the relevance and proportionality of the proposals**.

First, we do believe that the BCBS' proposals are founded on weak evidence of window dressing.

We wonder about the source of these perceived window-dressing practices and the factors identified by the Basel Committee insofar as balance sheet movements are directly linked to client activity and exchange rate changes at the end of the period. In this study the BCBS jumps to the conclusion of a wide use of window dressing by banks based on the observation of year-end contractions on OTC derivatives and repos that can be explained, among other factors, by market practices and regulatory requirements. The working paper does not explore these other phenomena behind the observed variations and the revised framework extends the measures to the whole scope of indicators of the GSIB framework without clear evidence of window-dressing on any of the items of the score.

Feedback on BCBS Working Paper 42

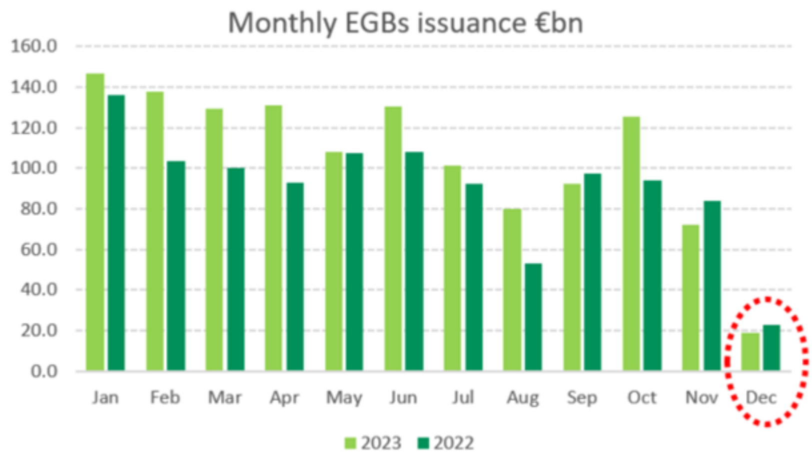
As previously mentioned, we are concerned that the analysis presented in BCBS WP42 is not sufficiently robust to conclude that a) there is evidence of window-dressing behaviour, and b) this provides a rationale for the BCBS proposal to change the data frequency requirements in relation to the wider G-SIB indicator set. On the former point it is highly regrettable that the authors didn't speak with the industry, we believe that the BCBS should conduct further analysis and dialogs 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). To note that these factors would potentially apply across the wider set of banking entities, beyond those designated as G-SIBs. A few examples that 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, volumes in secondary government bonds are also lower at year-end (Figure 1 – French and German GB) and even more for European Gov. Bonds Issuance (Figure 2 - Eurozone, GE, FR, SP and IT being the biggest contributors) while repo volumes are very 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 WP42 graph 1a (Europe) only show net exposure for repos (Size indicator in GSIB) while the same graph measured in terms of gross repos would have shown less variability.

Derivatives.

BCBS WP42 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 on a regular basis multilateral compression cycle[1] 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[2]. Compression cycles are not related to window-dressing, it is mandatory for significant players, it allows to limit the level of risk and one couldn't blame banks to do it also at year end.

All in all, we would recommend the authors and authorities to discuss with the industry to better understand and assess the impact of external factors that would help to focus on real window dressing if any.

Second, the limited impact of a potential window dressing should be taken into account.

Factually, it is just to observe that, within the G-SIB indicators, the OTC derivatives and repos are not considered as a single G-SIB indicator, however, based on studies performed by industry associations (AFME-IIF-GFMA), window dressing behaviours on these instruments would have a limited impact on total GSIB score (considering around 15% contraction observed within WP 42 on volumes of OTC derivatives and repos) i.e. 2% on a GSIB score which would induce an impact of 6 pts considering an average 300 pts GSIB. This limited impact does not justify the heavy burden induced by the envisaged revision proposed within BSBC consultation.

Third, any proposed changes to the current framework should be proportional to the anticipated regulatory/ supervisory benefits, and also should not result in unintended consequences (such as reduced data assurance/ quality).

In relation to the specific averaging frequency options that the BCBS explores in the consultation paper, **we would strongly recommend that the BCBS avoids a daily/monthly-averaging approach**. From our perspective, this would represent a materially significant challenge for banks (hence very significant investments which appear not proportionate in regard to the limited benefits foreseen through these higher frequency), particularly those with complex structures and moreover with those with insurance subsidiaries and for banks structures that shows a balance sheet inertia resulting for the activity.

Considering the lack of evidence of window dressing and the limited impact it could have, we are questioning the proportionality of the proposed measures. Therefore, **we recommend that the BCBS limits requirements to a quarterly reporting, subsequently take stock of the new situation.**

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[1] *Portfolio compression is a post-trade netting technique through which market participants can modify or remove outstanding contracts and create new ones in order to reduce their overall market gross position without modifying their net positions*

[2] *Market participants with more than 500 over-the-counter (OTC) trades on their books are required to examine the possibility of performing portfolio compression twice a year*

In addition, we believe that **supervisors are already in a position to mitigate window dressing behaviour.** As a matter of fact, there are several examples in Europe where the supervisors decided to move or maintain a G-SIB in a higher bucket (or to keep an institution in the list) therefore any window dressing evidence could participate (or have participated) to such reclassification. Supervisors can, in this context, rely on ad-hoc data collection at different frequencies to investigate on these practices if need be.

Accordingly, we see little if no merit to the proposed revision to the assessment methodology for G-SIBs indicators of using higher-frequency (i.e. daily or monthly) averaging as the default reporting frequency. A higher frequency (than quarterly) across all indicators and for all participating banks is unfeasible and would be very disproportionate for a very limited added value from a regulatory perspective be it for international banking groups, that will have to collect a very granular data from a large number of entities, for banks whose core business (i.e. retail banking) entails balance sheet inertia or for groups with insurance subsidiaries.

Specific comments to the proposed revisions to the assessment framework.

Scope of application of an averaging requirement.

*The Committee is accordingly seeking feedback on approaches to t**he scope of application of an averaging requirement** as described above: (a) apply the same averaging frequency to all banks in the G-SIB assessment sample and in the additional G-SIB sample; (b) apply a higher averaging frequency to banks in the G-SIB assessment sample and a lower frequency to banks in the additional G-SIB sample; and (c) apply a higher averaging frequency to G-SIBs and banks in the reporting sample that are close to the 130 basis point G-SIB identification threshold (based on a numerical cutoff) and a lower averaging frequency to other banks in the G-SIB assessment sample and to banks in the additional G-SIB sample.*

As already said, we recommend that the BCBS limits requirements to a quarterly reporting and that any specific focus should be done through ad hoc data collection by supervisor not to penalize the broad industry or a set of it.

Averaging frequencies.

*The Committee has been giving consideration to a broad range of **averaging frequencies,** including daily average, average over month-end values and average over quarter-end values. The Committee sees benefits in using the average of daily values over the financial year for the calculation of the stock data items, rather than financial year-end values, as this would negate any window-dressing incentives. Nonetheless, the Committee is seeking feedback on the broad range of averaging frequencies outlined above.*

We consider that collecting data using higher frequencies – daily or monthly – are technically unfeasible given the significant operational costs that would be incurred to develop the systems to meet the proposed requirements.

Indeed, the indicators used in the GSIB score computation are based on the current quarterly reporting framework– mainly Common Reporting (COREP) of the European Banking Authority (EBA) and FINREP -. It allows the GSIB 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.

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 a process would lead to unbearable costs for the Institutions.

A generic application of daily averaging would represent a huge step-change for banks and would be unachievable for the majority of indicators (even presuming significant infrastructure change/ investment) – the same applies for the majority of indicators in relation to monthly averaging. Beyond the inability to produce reliable indicators on daily/monthly frequency especially within the timeframe envisaged in the consultation, the significant investments necessary to reach such capacity appear clearly disproportionate regarding the limited benefits foreseen through this revision of the GSIB framework.

Furthermore, a requirement to implement daily/ monthly averaging within the proposed timescale would lead to the development of proxy measures by banks (to fill the gap between the precise GSIB indicators and the existing indicators in other reporting frameworks) in order to satisfy a daily/ monthly averaging requirement (as done and accepted on the Memorandum items section of the end 2023 exercise) which leads to comparability and reliability issues (that would not be acceptable for GSIB score determination), especially since the G-SIB scoring methodology is a relative exercise.

This is illustrated below for several indicators:

<u>OTC derivatives.</u>

- From a risk-based perspective, banks have implemented a variety of internal reporting cycles in respect of their OTC derivatives/ SFT trading positions, which range from daily/ monthly averaging. However, this would not be necessarily relevant or achievable in the context of the BCBS G-SIB reporting framework, given that the latter framework relies upon a non-risk based notional exposure measure. Banks do not currently have the ability to produce notional daily average measures, while a monthly average measure would still require significant customization for BCBS G-SIB data purposes.

- The notional measure is not currently reconciled beyond an end-year control check – while a quarterly reporting period would be manageable, anything beyond this (such as monthly frequency) would involve disproportionate checks & resources compressed into a tighter time-period (thereby potentially undermining data assurance).

<u>Size</u>

- In relation to the BCBS G-SIB Size indicator block, a daily average measure for G-SIB reporting purposes would not be achievable without disproportionate infrastructure changes/ investment, while a monthly average measure would present similar challenges. Given that G-SIB reporting reconciles to other regulatory reports, in the event that a daily/ monthly averaging frequency was imposed by the BCBS, banks would not only need to utilize a new data source, but they would also lose the control check to other reports.

<u>Interconnectedness/ Substitutability/ Complexity/ Cross-Jurisdictional Activity</u>

1. In relation to the Interconnectedness/ Cross-Jurisdictional Activity G-SIB indicator blocks, the majority of our members have provided feedback that a daily average measure for G-SIB reporting purposes would not be achievable without disproportionate infrastructure changes/ investment, while a monthly average measure would present similar challenges.

Members have stated that that securing sufficiently granular data would be a challenge, as well as having sufficient counterparty breakdown.

2. In the case of intra-financial assets & liabilities, banks with complex cross-border groups containing multiple entities would face significant challenges in capturing and calculating this information on a daily/ monthly average basis. Similarly, in relation to cross-jurisdictional claims & liabilities, members have indicated that in their current practice these data items are populated by utilizing data from other reporting forms, some of which have reporting time lags beyond 30 days.

3. Moving intra-financial assets & liabilities, along with cross-jurisdictional claims & liabilities to more frequent reporting (i.e. daily) would therefore not only increase production system demands but also require a fundamental reengineering of data production and control processes. Moreover, even after a reengineering, members do not believe it would be feasible to complete all controls, reconciliations, adjustments and reviews of this complex data set on a relatively high-frequency basis.

However, we agree that for calculation consistency purposes, it would be preferable that all items are calculate the same way which leads to the frequency issue as, in this context, quarterly reporting is the only option.

It is thus our belief that the only frequency that can be envisaged to ensure the robustness and the accuracy of the GSIB score computation and avoid significantly high operational costs for Institutions would be an average based on quarter-end values.

Furthermore, local supervisors can request ad-hoc data collection at different frequencies to investigate on these practices if need be.

Scope of banks.

The Committee is also giving consideration to the scope of banks to which the revisions would apply. The Committee sees the benefits of a wide application of the revisions to all banks participating in the G-SIB assessment exercise, but it is also seeking feedback on options that would apply those changes to a narrower set of banks to reduce the reporting burden.

The application of the higher frequencies to banks participating in the G-SIB exercise will be too costly and disproportionate, notably for international banking groups, as data will have to be collected at a too granular level from a large number of entities, including insurance, within the groups.

We consider that for calculation consistency, level playing field and comparability purposes, quarterly frequency is the only acceptable and feasible option. Any higher frequency should be limited to ad-hoc requests from supervisors, targeting specific banks and specific items (e.g. OTC derivatives and repos).

In addition, in the case of banking insurance groups, we believe that extending the scope of the proposed revised framework of the G-SIB indicators to include insurance entities would make no sense as the supposed issue of window-dressing is not relevant for insurance entities.

Implementation date.

The Committee proposes an implementation date of 1 January 2027 (ie starting from the end-2026 G-SIB assessment exercise), with a transitional period starting on 1 January 2026.

On the proposed implementation timeline, we note that the extent of any proposed BCBS changes to data averaging requirements will impact on the extent of required operational changes, which may impact banks' ability to meet the proposed 1 January 2027 implementation deadline (along with the proposed 1 January 2026 transition start-date). This is particularly acute when combined with other mandated data / regulatory reporting change programs that banks are developing (e.g. around Basel 3.1, digitalization). Also the costs induced by the necessary duplication of main parts of the accounting process are disproportionate, especially in a context where both industry and authorities are seeking in some jurisdictions to reduce reporting costs. Therefore, we would recommend that the BCBS consider rephasing the proposed implementation deadline, so that it does not create a planning/ resource challenge for banks who will be already engaged in advanced planning around Basel 3.1 proposed reporting changes.