HSBC

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30 June 2017

Dear Sirs,

Global systemically important banks – revised assessment framework – consultative document

HSBC welcomes the opportunity to respond to the Basel Committee on Banking Supervision's ('the Committee') consultative document ('the consultation') on revisions to the global systemically important banks ('G-SIB') assessment framework published in July 2013.

We welcome a periodic review of the G-SIB assessment methodology and are supportive of the guiding principles[1] used to assess against the proposed changes, however, while many of the proposed revisions are significant, these fail to take into account important advances in regulatory reforms which have occurred since the inception of the G-SIB framework. Furthermore, the measures also retain inherent weaknesses within the existing methodology and introduce new flawed aspects, resulting in an overall framework that operates as a levy on size and is not reflective of actual levels of systemic risk.

Our main points are summarised below, with more technical commentary added in the appendix to this letter.

Failure to keep pace

Capital buffers are not the only mechanism to address and mitigate the negative externalities associated with *'too big to fail'*. Other measures are also important in reducing the likelihood of failure at large banking groups and/or reducing the economic impact if failure occurs. Namely:

Resolution

In recent years, significant developments have been made in the resolution framework. At the time of Basel's original G-SIB consultation in 2011, resolution strategies were nascent.

This is far from the case today, yet the G-SIB assessment methodology has not evolved to keep pace with these changes. Importantly, the Financial Stability Board (FSB) has created an

1 BCBS Consultation, page 7: Principle 1: Changes should be consistent with the fundamental principles of the G-SIB framework; Principle 2: Changes should be both sound and implementable; Principle 3: Changes should be consistent with the objectives of the Committee's overall regulatory framework.

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overarching resolution framework and principles, including a standard on loss absorbency capacity for G-SIBs. Its objective was the resolution of financial institutions, without systemic disruption, through legal requirements for co-operation, information exchange and coordination between resolution authorities. Resolution regimes are now at an advanced stage of implementation, and this progress needs to be reflected in the G-SIB framework.

HSBC has also now received regulatory endorsement as a Multiple Point of Entry ('MPE') group and received a Total Loss-Absorbing Capacity ('TLAC') requirement on this basis. Our organisation into multiple resolution groups, with reduced operational dependency between entities and the consequent separate capitalisation and funding structure, required for each of our resolution groups, reduces the impact of failure of HSBC as a G-SIB. This ensures the orderly resolution of any part of the group, independently of each other, without either interruption of critical economic activities or recourse to public funds.

Furthermore, the introduction of the FSB's standard for TLAC has been important in identifying the financial capacity necessary to stabilise an entity in resolution. The TLAC requirements are set, following a bank specific assessment, whereby resolution authorities will assess the loss absorbing capacity they believe is necessary for specific banking groups in order to stabilise operations, particularly critical functions, post resolution. The standard also sets out the basis for the distribution of TLAC within a group, such that it is available, across the group, to absorb losses where needed, thereby reducing systemic risk.

Overall, the implementation of our MPE resolution approach and the issuance of TLAC should be reflected in the amount of any G-SIB surcharge imposed on HSBC on a consolidated basis. The G-SIB capital surcharge, as it currently stands, appears to operate as a mere tariff on size which is disproportionate and misaligned with the resolution framework. This results in excessive capital requirements, by ignoring the measures that the group has implemented towards resolvability which both reduce the probability of bank failure as well as the systemic impact.

Stress Testing

Similarly, it is also important to recognise regulatory progress in the area of stress testing. This provides regulators with valuable information as to the degree of systemic risk within the banking system and its' supervised banks. We suggest that micro and macro prudential supervision be reconciled and the insight obtained from firms' individual stress testing exercises be factored into the quantification of the G-SIB buffer for the firm.

Inherent flaws in the G-SIB framework

Tax on size

As previously mentioned, the G-SIB capital surcharge, in its current guise, appears to operate as a tax on size. While the approach of tiering banks based upon systemic risk, is not itself a source of concern, at its heart the framework places considerable emphasis on metrics which are directly size-related or a close proxy for size. Instead it should give more focus to the operating models of banking groups, their underlying complexity and associated risk mitigation.

Importantly, any resulting numerical indicators and averaging calculations should be supplemented by an assessment of its organisational structure and resolvability measures.

Furthermore, the continued use of a relative methodology for determining the score and therefore the surcharge, may not provide appropriate incentives for an industry-wide reduction of systemic importance. Rather, an absolute measure would sufficiently encourage banks, both individually and collectively, to reduce their systemic importance.

Cross-jurisdictional activity

It is disappointing that the Committee has not taken this opportunity to fundamentally re-define its definition of cross-jurisdictional activity, such that all activity between headquartered and non-headquartered locations remains captured.

As a UK headquartered bank, intra-country activity outside this jurisdiction, whereby a Hong Kong dollar deposit by a Hong Kong resident in a Hong Kong incorporated bank, is classified as a cross border liability. We would maintain that such intra-country activity is less globally systemic than business which is truly undertaken across borders. Additionally, the present definition takes no recognition of the separate capitalisation and funding inherent to our MPE structure. Where a group is structured through multiple legal entities and has local assets funded by local liabilities, the current approach misrepresents the scale of genuine cross-jurisdictional claims and liabilities within that organisation.

We would encourage the Committee to revisit this definition, as currently, it unduly penalises banks with operations in locations outside where it is headquartered and arbitrarily promotes an un-level playing field.

Double-Counting

We would encourage the Committee to use this opportunity to review the level of overlap within the G-SIBS methodology, in particular:

The extension of the cross-jurisdiction measure to include derivatives both exacerbates the impact of its definitional shortcomings and represents a double-count within the overall methodology. Derivatives are already captured within various indicators, namely through the complexity, size and interconnectedness[2].

Separately, resolution groups are already subject to systemic risk capital buffers on a domestic basis. It is difficult, therefore, to reconcile local applicable TLAC requirements and capital buffers separately calculated for resolution groups under an MPE approach, with the calculation of a G-SIB buffer applied on a consolidated basis under the current methodology.

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[2] *Derivatives are included on a notional basis within the complexity indicator; the potential future exposure of derivatives contracts is also included in the size indicator; and OTC derivatives with other financial institutions are captured in the interconnectedness indicator.*

New flaws

We are particularly concerned about the expansion of the scope of consolidation for the G-SIB methodology to include insurance entities. While we recognise that bank owned insurance entities are not captured by the insurance systemic framework, it is unclear why the G-SIB framework is considered an appropriate mitigant.

Separately, we would also caution against the inclusion of derivatives in the cross-jurisdictional indicator as it currently captures non-financial counterparties. This will inevitably lead to an impact on the economy as banks could be disincentivised to provide hedging services to corporates.

Conclusion

As it stands, this consultation appears to be a missed opportunity to recognise regulatory developments and incentivise resolution strategies that reduce the systemic impacts of bank failure. Instead, the G-SIB framework continues to operate largely as a tax on size. Consequently, the Committee should work closely with the FSB's Resolution Steering Group to consider appropriate adjustments for consultation on a joint basis.

We have provided more technical commentary in the appendix to this letter. Our comments deal with the specific areas being consulted on by the Committee, with some final remarks on broader issues surrounding the current G-SIB framework.

We would be pleased to discuss any of these comments further, if this would be helpful to you and your colleagues.

Yours sincerely,

Iain J Mackay
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cc: Governor Mark Carney – Governor of the Bank of England and Chair of the FSB

Technical Appendix

Question 1: What are respondents' views on each of the proposed changes in the G-SIB assessment methodology?

1: Removal of the cap on the substitutability category

Basel definition of the "Substitutability/financial institution infrastructure":

The Substitutability/financial institution infrastructure category was introduced by the Committee as: *"the systemic impact of a bank's distress or failure is expected to be negatively related to its degree of substitutability as both a market participant and client service provider, i.e. it is expected to be positively related to the extent to which the bank provides financial institution infrastructure. For example, the greater a bank's role in a particular business line, or as a service provider in underlying market infrastructure (e.g. payment systems), the larger the disruption will likely be following its failure, in terms of both service gaps and reduced flow of market and infrastructure liquidity. At the same time, the cost to the failed bank's customers in having to seek the same service from another institution is likely to be higher for a failed bank with relatively greater market share in providing the service. Three indicators are used to measure substitutability/financial institution infrastructure: (i) assets under custody; (ii) payments activity; and (iii) underwritten transactions in debt and equity markets".*

Basel Proposal:

To remove the cap on the Substitutability category.

The Committee noted in its 2013 assessment methodology, that relative to other G-SIB categories, the substitutability component has had a greater impact on the assessment of systemic importance than the Committee had intended for banks dominant in the provision of payment, underwriting and asset custody services. As such, a cap was applied to the substitutability category.

The Committee now believes that: *"[the] use of the cap – or other non-linear transformations – reduces the impact of a category in the overall G-SIB score reducing banks' incentives to become less systemically important."* Therefore it proposes to: *"remove the cap on the substitutability category with the aim of providing banks with an incentive to reduce concentration in the provision of these services."*

HSBC response:

We support the proposed removal of the cap, given the initial introduction of the cap was an arbitrary measure.

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Additional comments:

We would like to take this opportunity to comment on a wider issue related to the current overall methodology which is illustrated by the substitutability category. Namely, the mechanics of the G-SIB calculation show that overall systemic score ranking is unduly impacted by its most changeable components. For example, the assets under custody and payments element of the substitutability category is particularly volatile. This also occurs in other components of the assessment, for example within the complexity category where the notional amount of OTC derivatives tend to fluctuate materially. This issue distorts the original intention of the G-SIB framework, which was to apply equal weights to all categories. As such, we encourage the Committee to progress in developing an approach for measuring systemic risk that would remove the statistical bias and the disproportionate influence individual categories have on the value of the systemic-risk scores, rather than through the retention of arbitrary caps.

2: Expansion of the scope of consolidation to include insurance subsidiaries

Basel Proposal:

The Committee proposes to expand the regulatory scope of consolidation in the G-SIB framework to include exposures from insurance subsidiaries in the G-SIB categories that, in its view, best reflect the systemic risks common to banks and insurers. Namely: size, interconnectedness and complexity.

HSBC response:

We oppose the inclusion of insurance subsidiaries in the scope of the G-SIB framework.

Additional comments:

We oppose the inclusion of insurance subsidiaries in the scope of the G-SIB framework as it is inconsistent with the Basel capital framework, which expressly excludes insurance subsidiaries from the prudential scope of consolidation.

Furthermore, the deconsolidation of insurance subsidiaries for regulatory capital adequacy purposes, requires the deduction of insurance subsidiary capital, with the cost of investment subject to threshold deductions. Through this treatment, we believe that prudential capital requirements already reflect group-wide risk, which includes insurance interests. The inclusion of insurance subsidiaries for the purposes of the G-SIB assessment methodology would, therefore, result in duplicative requirements. It is therefore unclear why the Committee feels it appropriate to hold additional CET1 capital within the banking entity specifically under the G-SIB capital buffer.

While it is noteworthy that the Committee suggests that the inclusion of insurance subsidiaries will *'reduce the potential for regulatory arbitrage'*, it does not elaborate the circumstances in which it is perceived this would occur. In which case, we would encourage the Committee to explain the nature of the perceived risk. Any perceived short-comings should be both explained

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and demonstrated with appropriate empirical evidence. Ultimately, if such a risk is found prevalent, it is our view that the capital should be required to be held where this risk arises.

Should the Committee have concerns regarding the consistent Pillar 1 capital treatment of insurance entities across jurisdictions, then this would be more appropriately addressed by prescribing a more uniform approach and/or utilising its Regulatory Consistency Assessment Programme (RCAP) to highlight inconsistencies in national approach.

Whilst it is essential that the Committee explain the nature of the perceived risks and how they arise in practice, we believe it appropriate that any arbitrage risk be addressed through greater cooperation between banking and insurance supervisors. In this case we would encourage the Joint Forum of Senior Financial Sector Supervisors to address any such concerns by encouraging cross-sectoral consistency and alignment where appropriate as per their mandate.

3: Amendments to the definition of cross-jurisdictional activity

Basel Definition:

"The objective of this indicator is to capture banks' global footprint. Two indicators in this category measure the importance of the bank's activities outside its home (headquarter) jurisdiction relative to overall activity of other banks in the sample: (i) cross-jurisdictional claims; and (ii) cross-jurisdictional liabilities. The idea is that the international impact of a bank's distress or failure would vary in line with its share of cross-jurisdictional assets and liabilities. The greater a bank's global reach, the more difficult it is to coordinate its resolution and the more widespread the spillover effects from its failure".

Basel Proposal:

The Committee proposes to introduce a new Cross-Jurisdictional Liability (CJL) indicator, to include derivative liabilities.

HSBC response:

We disagree with the inclusion of derivatives and have concerns with the proposal given the overlap and double counting of derivatives in various G-SIB indicators. Also, we believe the revision of this category falls short of addressing fundamental flaws within its existing definition.

Additional Comments:

We have concerns with this, for a number of reasons, detailed below.

The inclusion of Derivatives

The extension of the cross-jurisdiction measure to include derivatives is a double count within the overall methodology.

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Derivatives are already captured within other indicators. Namely:

- derivatives are included on a notional basis within the complexity indicator;
- the potential future exposure of derivatives contracts is also included in the size indicator, and
- OTC derivatives with other financial institutions (net positive and negative fair value) is again captured in the interconnectedness indicator.

As such, we would urge the Committee to use this opportunity to review the level of overlap between the indicators.

Where derivative activity is then retained within the G-SIB framework, we believe that the introduction of regulatory incentives to centrally clear derivatives, should also now be reflected in the G-SIB calculation.

Also, we would strongly oppose the inclusion of derivatives with non-financial institutions, and we are concerned about unintended consequences. Whereby banks are effectively disincentivised from offering corporate hedging facilities given the potential increase in the cost of capital allocated to fund this business.

Inherent flaws in the cross-jurisdictional definition

Additionally, we are disappointed that the Committee has, once again, not recognised the need to change the definition of cross-jurisdictional activities to exclude intra-jurisdictional activity. Whereby, a cross-border UK headquartered bank, is currently penalised for any activity outside of its location of incorporation. For example, under the existing framework a Hong Kong dollar deposit by a Hong Kong resident in a Hong Kong incorporated bank, regulated and supervised by the Hong Kong Monetary Authority, is classified as a cross border liability. This definition of cross-jurisdictional activity erroneously penalises a group which is structured through multiple legal entities and has local assets funded by local liabilities. This misrepresents the scale of genuine cross-jurisdictional claims and liabilities within that Group.

In light of the above we would propose that only true cross-border activity which spans from one border to another, is included in this measure. For example, a loan originated in the United Kingdom to a counterparty in France would be cross-jurisdictional. Should the Committee believe that local claims and liabilities should remain in the methodology, these should be computed net of local liabilities – for example, a Hong Kong local mortgage portfolio wholly funded by local Hong Kong deposits should be excluded from the claims balance.
This intra-country activity is less systemic than business which is truly undertaken across borders. We would encourage the Committee to revisit this definition in order to achieve the right objectives of correctly identifying and quantifying G-SIBs. Currently, it unduly penalises banks with operations in different locations from where it is headquartered and arbitrarily promotes an un-level playing field.

Furthermore, there is a fundamental misalignment with the remaining regulatory framework for G-SIBs. The Committee has stated that the underlying objectives of the cross-border indicator was to take into account the risk that the resolution of a multi-jurisdiction banking group would be technically more difficult in case of failure and that an additional capital buffer was therefore warranted.

According to the BCBS: *"The greater a bank's global reach, the more difficult it is to coordinate its resolution and the more widespread the spillover effects from its failure"*. However, such an approach denies the importance of the adoption of the FSB's key attributes of effective resolution regimes for Financial Institutions ("key attributes") endorsed by the G20 Heads of States and Government in November 2011[3]. The objective of the key attributes is precisely to make feasible the resolution of financial institutions without severe systemic disruption. This is achieved by providing, amongst other key aspects, for a legal requirement for co-operation, information exchange and coordination domestically and with foreign resolution authorities before and during resolution. Resolution regimes are being implemented in accordance with these international standards and the progress achieved needs to be reflected in the G-SIB framework.

In particular, under the key attributes, G-SIBs are subject to resolvability assessments that evaluate the feasibility of resolution strategies by resolution authorities. To the extent resolution authorities deem necessary, they have the powers to require commensurate changes to a firm's business practices, structure or organisation, to reduce the complexity and costliness of resolution and enable the continued operations of systemically important functions – this may involve evaluating whether to require that these functions be segregated in legally and operationally independent entities that are shielded from group problems. It seems logical that any concerns around the resolvability of a G-SIB are evaluated within this framework and that the G-SIB framework is consistent with the wider resolution framework. Related to this, it is crucial to recognise the advantages of a MPE approach to resolution towards achieving resolvability.

Issue specific to the Cross-jurisdictional definition – relevant data for information of the Basel Committee

As stated previously, we believe that the current definition of cross-jurisdictional activities is fundamentally flawed. Whereby in relation to local claims/liabilities transacted in local currency and funded locally by a subsidiary (which could be itself subject to a Domestically Systemic – 'DSIBs' requirement) is classified as cross-border. This anomaly leads to a fundamental misrepresentation of cross-jurisdictional activity that needlessly penalises a legal structures that minimises cross border assets and liabilities.

This is a significant issue. In respect to the Cross-jurisdictional category, as per our year-end 2016 G-SIB Assessment Exercise, HSBC's local claims of foreign affiliates in local currency contributed to 61% of the total figure. Within the same category, HSBC's local liabilities in local currency contributed to 51% of the total figure reported in the prescribed template.

We propose to either remove this specific element from the cross-jurisdictional definition or to report the data on a net basis given the relatively low risk attribution of these exposures.

[3] As supplemented by the FBS's added guidance in 2014.

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The Committee should now be mindful that the impact in percentage terms of the above will be further accentuated by the consultation proposal to include derivatives.

4: Modification of the weights in the substitutability category and introduction of a trading volume indicator

Basel (current) approach:

Three indicators are currently used by the Basel Committee to measure substitutability/financial institution infrastructure: (i) assets under custody; (ii) payments activity; and (iii) underwriting transactions in debt and equity markets. Each indicator within this category is given an equal weight of 6.67%.

Basel Proposal:

To revise the category's indicators to lower the underwriting indicator from 6.67% to 3.33% and introduce a new indicator on trading volume with a weight of 3.33%.

According to the Committee, the underwriting indicator has shown "*a fair amount of year-to-year volatility*"; whilst the trading volume indicator is considered by the Committee as necessary to better address the substitution risk arising from the failure of substantial infrastructure systems that support the market-making activities of G-SIBs. Whereby it would reflect banks' activities in the secondary market and, furthermore, "*by adding a trading volume indicator and reducing the weight on underwriting, the banks' scores are likely to be more stable over time, putting more emphasis on the structural dimension of systemic importance*".

HSBC response:

We disagree with the introduction of the trading volume indicator.

Additional comments:

We question the inclusion of this indicator as we believe it to be both volatile and complex to produce, due to the inclusion of intragroup activity. Furthermore it risks second order consequences for banks' role as market makers which is essential for global trade.

5: Revisions to the disclosure requirements

Basel (current) approach:

Banks are required to disclose the G-SIB indicators in their public financial statements, on their corporate websites or via publicly available regulatory reports.

The Basel Committee confirms that: "*The importance of market discipline underpins the Committee's proposal for banks to publicly disclose the final data used to calculate the G-SIB scores. Typically, any differences in the data disclosed by banks and used in the G-SIB* *calculations have not been material enough to affect the [G-SIBs requirement] assigned to banks in the G-SIB sample. Nonetheless, it is important to note that data corrections affect not only the score of the reporting bank, but all banks in the sample, given the relative nature of the framework as each bank's values contribute to the denominator*"

Basel proposal:

To require banks to disclose the indicators used in the final G-SIB calculations. The Committee states: "*This proposal may have the implication of obliging some banks to re-state their public disclosures if they occur prior to August of the calendar year. To ensure consistency with the revised Pillar 3 reporting requirements, the Committee proposes that: On an annual basis, banks are required to disclose at least the 12 high-level indicators used in the G-SIB assessment based on financial year-end data. Banks should note in their disclosures that those figures are subject to revision and re-statement. Banks must further publicly disclose if the data used to calculate the G-SIB scores differ from the figures previously disclosed. To the extent that a revision to the data is required, banks should disclose the accurate figures in the financial quarter immediately following the finalisation of the Committee's G-SIB score calculation; and, Banks disclosures must follow Pillar 3 reporting requirements and timelines.*"

HSBC response:

We agree with the Committee's proposal to require the industry to disclose the indicators used in the final G-SIB calculation. We would however expect that the flexibility envisaged in the final BCBS Standards on Pillar 3 Disclosure requirements (March 2017) will be consistently applied to any re-statement of the G-SIB disclosure. Namely, we request the Committee to confirm that the revision doesn't necessarily have to involve a restatement of entire Pillar 3 report or financial filings, and could be instead updated via other channels, such as on a bank's website available to the public by signposting in the corresponding annual or interim Pillar 3 reports.

6: Further guidance on bucket migration and the associated surcharge

Basel (current) approach:

The current rules are silent on the timing of the release of G-SIB capital buffer in the event of a downward bucket migration.

Basel proposal:

The consultation proposes to immediately release the G-SIB capital buffer requirement when the G-SIB score reduces. The Committee believes this clarification would provide banks with strong incentives to reduce their systemic importance.

HSBC response:

We are supportive of this change which is furthermore consistent with the approach taken in relation to other capital buffers, namely the countercyclical capital buffer. However, we seek clarification that banks will be allowed to take this benefit before the revised rules are in place. For example, if the G-SIB requirement was lower in the 2018 assessment year than in the previous year, we envisage that any resulting downward bucket migration should take effect immediately.

7: Transitional schedule

Basel proposal:

The Committee sets out a transitional timetable to allow banks and authorities to implement the changes following the adoption of the revised framework in this consultation. The proposal is that any revisions announced/published in November 2017 would take effect in 2019 (based on end-2018 data), and the resulting G-SIB capital buffer requirement would be applied in January 2021.

HSBC response:

We are concerned with the timing for implementation. The implementation schedule for these proposals coincides with a number of other amendments to the Basel 3 framework. This will result in a significant amount of change during a condensed period.

Additionally, we note that the Committee intends to issue a quantitative impact (QIS) assessment of the G-SIB revisions after the end of the consultation period. While welcome, we believe it would be appropriate to share and publish the results of such impact assessment with the industry and potentially allow for further consultation before any revisions are announced as final.

Q2. What are respondents' views on potentially including Short-term wholesale funding (STWF) as an indicator in the interconnectedness category?

Basel proposal:

The Committee is considering revising the G-SIB assessment framework by introducing a STWF indicator in the interconnectedness category.

The definition proposed by the Committee would comprise the proportion of all sources of a bank's wholesale funding with a maturity of less than six months (based on data used to compute the Net Stable Funding Ratio (NSFR)). The Committee states that the Liquidity Coverage Ratio and NSFR may be useful for preventing investor runs, however, that once a run has begun these rules may lack the flexibility needed to limit social losses. A high dependence on short-term funding can exacerbate system-wide losses, leading to fire sales, reduced lending and divestments.

HSBC response:

We strongly disagree with this proposal.

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Additional comments:

We would strongly oppose the introduction of such an indicator which effectively transforms a liquidity risk into a G-SIB charge.

The measure inadequately discriminates between deposits that a bank needs to fund its operations and deposits that a bank's customers chose to place with it. In a stressed scenario, a *'flight to quality'* would be expected, such that the effect of the proposal becomes counter-intuitive, as it will unduly penalise 'safer' banks. This in itself could force safer banks to refuse deposits, which would be both socially undesirable and further exacerbate the stress.

The stability of funding should not necessarily be defined by its contractual maturity[4] but instead it should be based on the underlying stability of the liability and the reason behind that stability.

The consultation proposes to capture the following four sets of liability funding as STWF:

- Operational deposits
- Non-operational deposits and funding from non-financial entities
- Secured funding with a maturity of less than 6 months
- Non-operational deposits and other wholesale funding from financial institutions

From our perspective, it can be argued that both operational deposits (which are a by-product of clearing, custody and cash management requirements) and deposits from corporates, are generally viewed as stable deposits.

Secured funding is also more stable than unsecured deposits, when under stress, due to the associated collateralisation, so should not be directly compared with the other categories of wholesale deposits.

Finally, non-operational deposits, and wholesale funding from financial institutions, has been innately unstable at certain times in certain jurisdictions and this is why banks hold 100% liquidity insurance against this when the term to maturity is less than 1 month.

The consultation refers to the dangers of fire sales and the contagion this may lead to. However, to assess the risk to an institution, the Committee should not only consider the probability of removal of the deposit (as outlined above) but also the fact there may be other mitigants to this risk besides a sale of assets. Examples of this would be the amount of freely withdrawable cash at central banks, and possible short dated reverse repo assets, alongside short dated lending and possible further collateralised borrowing (repo).

Finally, we would also argue that the risk of an increased probability of default (of cash flow insolvency rather than balance sheet insolvency) as caused by the wrong type of wholesale short

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[4] Based on the Committee's proposal to capture STWF with a maturity of less than 6 months (based on data from NSFR).

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term funding, can only be mitigated by very high quality liquid assets or central bank withdrawable assets and not by holding increased capital.

Overall, we believe that the Committee proposes an inappropriate definition of STWF which fails to measure the probability of default of a G-SIB and consequently, is unfit for purpose in the calibration of the interconnectedness category.

Additional technical comment on other aspects not covered in the consultation

We would like to draw the Committee's attention to the following residual areas of concern:

a) *Relative versus absolute scoring*

The G-SIB score calculation is currently calculated on a relative basis, we believe this approach creates significant insensitivities in the surcharge calculation. These are driven by the mechanics of the calculation which is based upon the sum of all GSIBs indicators in a small sample (75 banks). In this case a G-SIB will not be able to reduce its score unless, proportionally, scores for all other firms stay flat. Hence, we believe this does not appropriately incentivise firms to reduce their systemic scores. Practically, this approach also does not adequately reflect a situation where the system as a whole takes risk-reducing steps, therefore becoming safer, given the individual systemic scores would remain the same.

As a result, we propose to redefine the methodology to shift away from a relative ranking towards an absolute measure. This would enable a G-SIB to observe a meaningful reduction in its surcharge based on the reduction of its systemic risk profile. Using an absolute measure would also increase the predictability of the surcharge calculation, thus enabling firms to plan for future risk-reduction measures according to the direction of the GSIB's surcharge. Finally such a modification would encourage better regulatory outcomes as it increases incentives to lower systemic risk.

b) *Size*

We have already commented that the Size indicator is not a useful measure of systemic importance and would suggest this is recalibrated to be below the current 20% weighting. Furthermore, we would urge that the definition is reviewed and revised.

In particular, here it is counterintuitive to include assets that are held to either mitigate the risk of failure or in a 'failure' scenario are highly liquid and can thus be sold quickly to reduce disruption in the wider financial market. These should be removed from the measure. Similarly, non-credit obligation assets (fixed assets such as property and land) also do not pose risks and should be excluded.

c) *Interconnectedness*

The 'Securities Outstanding' indicator is not an accurate measure of 'Interconnectedness'. In our view it does not accurately reflect the extent to which a bank is connected to the broader financial system. Again, it is counter-intuitive that a 'safer' bank with a large capital base should incur a higher charge. The impact of this will be further compounded by a bank's issuance of

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TLAC; a measure which itself has been introduced to reduce the risk of failure which is attracting a higher charge in a different regime.

d) Complexity

We request the Committee take account of regulatory developments in the area of "*margining requirements for non-centrally cleared derivatives*" ('MRUD') in the calibration of the complexity indicator. The MRUD framework agreed by the Committee and ISDA will play an important role in reducing the systemic LGD of a G-SIB in the case that its counterparties default. Additionally, there should also be recognition of the collateral on bilateral trades, as this will better reflect the risk inherent in the banking system.

Additionally, we propose to replace the notional amount outstanding of OTC derivatives settled bilaterally with called initial margin, which we believe to be a more appropriate measure of the actual risk (instead of a size measure).

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