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Response to the Basel Committee on Banking Supervision consultation on the Core principles for effective banking supervision

Introduction

We are pleased to respond to the BCBS consultation on the Core principles for effective banking supervision, which would update the Core Principles to reflect supervisory and regulatory developments, structural changes in banking, and lessons learnt since the Core Principles' last revision in 2012. It is important that the Core Principles do not intrinsically introduce any new standards, either intentionally or unintentionally, which have not been previously consulted on introduced, and, through other relevant BCBS processes.

The Core Principles are an important benchmark to assess the effectiveness of regulatory and supervisory frameworks, and our membership is generally supportive of the proposed changes, which we understand are targeted not so much at larger regulators but at the those in countries where the approach to banking supervision is still evolving. The following recommendations are intended to ensure the proposed revisions to the Core Principles are properly calibrated and avoid unintended consequences.

Responsibilities, objectives, and powers

Data sharing

We have noted a growing trend in recent years towards requirements for data localisation from some jurisdictions. We believe that it is important that data is shared transparently amongst regulators responsible for supervising an internationally active banking group. to ensure that supervisors have a full picture of a bank's overseas exposures. So supervisory college members should have access to data they need within the scope of their mandate require but through the 'gateway' of the home state regulator. In part this will ensure that all relevant data protection laws, particularly in relation to individuals' data, are respected. This will assist banking groups operating over multiple jurisdictions by allowing supervisors to have access to data from across the group, but via the home state consolidating supervisor. There is also a consistency point as assessment criteria (5) of principle 1 already mentions records - reference to it in the footnote 3 is unnecessary.

Recognition of Groups

We believe that Principle 13 should be modified to recognise the benefits of banking groups and require host supervisors to recognise those benefits when supervising local subsidiaries of banking groups. While we have observed a welcome increase in cooperation and information sharing across supervisory authorities, the benefits of such cooperation and information sharing have not yet been realised. Certain host requirements should no longer be necessary, as host authorities should be able to develop sufficient confidence in group-wide processes and approaches due to the improvements in cross-border supervisory cooperation and convergence of supervisory approaches internationally under the Basel framework.

Supervisory access to the board

The requirement that supervisors should have full access to the board, articulated in point 5 of Core Principle 1 including individual members (as in footnote 3), may be inconsistent with the principle of collegiality set under corporate laws of certain jurisdictions. Where such corporate law applies, any decision of the board will be reached as a result of a vote by board members. In such circumstances it is important to recognise that no individual board member can claim to be representing the board as they have no powers of their own over the business of the company.

Non-Bank Financial institutions (NBFIs)

We agree that the significant evolution of financial intermediation since the last review of the Core Principles has been driven in large part by the growth of Non-Bank Financial Institutions (NBFIs). Any changes to the Core Principles that are intended to address the risks arising from NBFI activities should be based on the concept of “same activity, same risk, same supervisory approach.” Embedding this concept in global standards is necessary (a) to ensure a level playing field between traditional banking firms and NBFIs that engage in economically equivalent activities and (b) to prevent NBFI activities from threatening the safety and soundness of a jurisdiction’s financial system.

Putting the responsibility for mitigating systemic risks from shadow banking on the bank's counterparty credit risk management, while policy discussions on adjustments to the regulatory framework for NBFIs continue, does not seem to be appropriate.

Independence, accountability, resourcing, and legal protection for supervisors

Proposed Core Principle 2 currently states, *‘The supervisor has full discretion to set prudential policy and take any supervisory actions or decisions on banks and banking groups under its supervision.’* We believe this text should be revised to state, *‘**To the extent permitted under the laws of its jurisdiction**, the supervisor has full discretion to set prudential policy and take any supervisory actions or decisions on banks and banking groups under its supervision.’* It is important that the Core Principles not encourage the exercise of supervisory powers that exceed the powers granted to them under the general legal framework of a jurisdiction.

Risk management process

We appreciate the updates to the Core Principles should reflect the final BCBS Principles for the effective management and supervision of climate-related risks (June 2022). However, it has been pointed out by some of our members the need to emphasise that climate-related financial risks are a driver of existing risk types (e.g., credit, market, operational, liquidity, or legal risks), rather than a distinct risk type, and are generally incorporated into banks' existing risk management frameworks. As such, we question the number of explicit references to "climate-related financial risks" throughout the revised Core Principles, with no mention of these actually being drivers which may create confusion around this point.

Proposed Core Principle 15, for example, states that "The supervisor determines that banks have a comprehensive risk management process (including effective board and senior management oversight) to identify, measure, evaluate, monitor, report and control or mitigate all material risks (including, but not limited to, climate-related financial risks and emerging risks assessed over relevant time horizons)…". The explicit reference to climate-related financial risks, and not to other risk drivers or even to traditional risk types, may not only place outsized weight on these considerations relative to the broad spectrum of risks and risk drivers that banks must consider, but also implies that climate risk is its own risk type rather than a driver of existing risk types.

We note that the BCBS has already laid out its definitions for climate related risk in their April 2021 publication *Climate-related risk drivers and their transmission channels*, and it is made clear here that these are drivers of existing risk types. So, we would like to see this added to the reference documents in the footnotes of Principles 8 and 15. We have noted that there is no reference to this document in the proposed changes and adding it to the footnotes would direct readers to the BCBS' own definition and avoid any ambiguity.

Alternatively, the 2023 insertion of the wording "(including, but not limited to, climate-related financial risks and emerging risks assessed over relevant time horizons)" be removed from the draft so that supervisors can continue to exercise their discretion over these risks.

Principle 16 – Capital adequacy

Proposed Core Principle 16 includes an additional criterion that:

> *"Laws or regulations permit the supervisor or relevant authorities to require banks to maintain additional capital (which may include sectoral capital requirements) in a form that can be released when system-wide risk crystallises or dissipates."*

We would appreciate further clarity about what the BCBS contemplates with the addition of the reference to a sectoral capital requirement. In addition, it is essential that any such optional sectoral capital requirements are not used to impose Pillar 1 climate change related capital requirements, which are not warranted.

Problem exposures, provisions, and reserves:

Proposed Core Principle 18 Assessment Criterion (4) states, '*The supervisor determines that banks' credit loss provisions and write-off methodologies and levels are subject to an effective review and validation process conducted by a function independent of the relevant risk-taking function.*'

In general, we agree that this is valid and holds true for provisions calculated by a model (i.e. for the performing and the defaulted homogeneous portfolios). However, individual provisioning for defaulted non-homogeneous assets is not model based. So, there is consequently no validation by an independent function and even a meaningful application of back testing is very limited as provisions are recalculated based on recent information on a quarterly basis (with no clear reference points). Specific risk provisions determined on client level based on expert assessment of the specific (idiosyncratic) circumstances are not part of this validation process. The Core Principles should make this distinction clear.

Operational resilience

Operational resilience is extremely important for the public and private sectors to maintain confidence in the financial industry and to support financial stability and economic growth. Operational resilience is important for individual institutions, and across the financial sector, in support of customers, markets and the communities and broader economies they support nationally and globally.

Operational risk and operational resilience operate on a continuum. As defined by the BCBS, operational resilience is an outcome arising from the effective management of operational risk. It is important that supervisors appropriately account for this relationship in order to avoid a bifurcation of risk and to permit firms to balance their prevention and recovery efforts.

Treating them separately increases risks associated with fragmentation. We encourage the BCBS to acknowledge the continuum and complementarity between operational risk management and operational resilience in the final Core Principles, perhaps as part of the introductory material that explains why the two topics are covered in the same principle (CP25). This overarching framing may help supervisors as they implement the Core Principles by allowing them to take a more outcomes-based and non-fragmented approach to supervision of these topics. This could be particularly helpful recognising some of the jurisdiction-specific initiatives underway.

We appreciate the clarity provided in the Essential Criteria, Section (9)(f) regarding contingency planning and development of exit strategies to ensure operational resilience in the face of service provider failures or disruptions. However, we would like to emphasise the importance of distinguishing between near-term disruptions and disorderly exit, and long-term orderly exit from a service provider relationship. The differentiation would enhance the utility of the principle in guiding risk management policies that account for both near-term disruptions addressed as part of resiliency plans, and long-term processes managed through effective exit strategies. From a supervisory standpoint, this distinction is critical for assessing an institution's ability to maintain the continuity of critical operations and demonstrating operational resilience in the event of either scenario.

It would also be helpful if the Essential Criteria, in particular section (9)(a) – (h), are attributable to the *Principles for Operational Resilience* and the *Principles for Sound Management of Operational Risk* to avoid inadvertent introduction of new expectations or standards which have not been previously consulted on.

Of course, we would be delighted to discuss with the Committee our views in more detail if this would be helpful.

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