SANTANDER SUBMISSION TO THE BASEL COMMITTEE ON BANKING SUPERVISION CONSULTATIVE DOCUMENT ON GLOBAL SYSTEMICALLY IMPORTANT BANKS

Santander welcomes the opportunity to comment on such an important topic. We have consistently supported the strengthening of the prudential framework in order to reach a more sustainable financial system and to support a recovery in market confidence. Curbing moral hazard and reducing systemic risk is instrumental in this regard. We consider the key answer to this is crisis management framework. We do not share that designating groups of firms as potentially systemic and applying additional loss absorbency requirements to these is the right answer.

Notwithstanding, if an additional capital is agreed, we acknowledge that this is an extremely challenging issue and we appreciate the effort made by the BCBS to develop a balanced approach stepping away from too simplistic (e.g. size as a single indicator) or too complex solutions (e.g. black box models). The progress made in such a short deadline is impressive and we see it as a **conclusive step forward in the identification of the potential sources of systemic risk.**

We especially welcome the following elements of the proposal.

First, we fully agree on **the introduction of a broad set of criteria to identify systemic risk**. As recognized in the BCBS paper, the contribution to systemic risk of each institution is driven by various risk factors embedded in multiple groups of variables. Using a single variable or a limited series of variables as a proxy for systemic risk would result in numerous errors when attempting to identify and measure the systemic risk of each institution. A prudential policy based on a single variable and on a single dimension of a variable would give rise to an incorrect categorization both of systemic institutions classified as non-systemic and vice versa, introducing inefficiencies and financial instability. In particular, the introduction of complexity within the quantitative criteria and the recognition of some role for qualitative factors make it possible to take into account important dimensions of systemic risk not captured by other criteria.

Second, we fully support **the gradual approach that introduces the right incentives and reduces moral hazard** by defining well differentiated clusters of institutions that exhibit similar profiles in terms of systemic risk. All financial institutions contribute to systemic risk, albeit to a different degree. Simply classifying institutions as systemic/non-systemic would mean giving similar treatment to institutions that may actually have very different degrees of systemic risk whilst treating very differently institutions that may present similar levels of systemic risk. In addition, the extension of the framework to Local SIFIs will close further the gap.

Third, we consider it very sensible **to recognize the need for further improvements and refinement in light of experience and progressive implementation**. Last year's debate on the measurement and treatment of systemic

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risk has proven to be very enriching from an intellectual point of view. The BCBS initiative has been the catalyst for a very lively discussion on this topic and has resulted in faster progress than otherwise would have been the case. However, the complexity of the issue suggests that we should keep an open approach in the medium term that allows us to take account of new developments in areas such as resolvability.

Notwithstanding our overall positive stance towards this proposal, we would like to make **some suggestions about how to further enhance the current approach**. Some of these we think could be quick wins while others could require further reflection, but we consider that they may be taken on board in future methodological reviews.

With respect to the quantitative criteria, our following comments could be addressed towards a November agreement:

1) The individual indicators used to capture ***cross-jurisdictional activity category*** do not, in our view, reflect what is intended in the proposal. If the idea is to factor in the potential complexity of a cross-border bank liquidation, then this should be done by focusing on the amount of cross-border transactions conducted by any of the legal institutions within a group rather than in the whole activity outside the parent headquarters. Thus the activities financed by an affiliate in the country and currency where it is domiciled should be considered local activities and not cross-border. We suggest that the ***cross-jurisdictional activity*** indicator would be better captured by the amount of cross-border flows. This would correspond to cross-border claims (A) plus local claims of foreign affiliates in foreign currency (B) as set out in table 1.2 page 11 of the guidelines of the international banking statistics. Therefore, this version of the indicator would not include local claims of foreign affiliates in local currency. Should this approach not be deemed desirable, then at the very least we would propose having two concurrent indicators, i.e, the original version (A+B`+C) proposed by the BSBC as well as the version we propose here (A+B).

2) The **wholesale funding** variable used in interconnection also requires further refining. The “wholesale funding ratio” is defined as the total liabilities less retail funding divided by total liabilities. As the accounting definition of total liabilities is not harmonised and includes many other things apart from funding (e.g. valuation adjustments, pension liabilities, etc) the ratio could be misleading. It could be better to define the ratio by using the sum of wholesale funding items rather than by the difference between total liabilities less retail funding as in the proposal or, at least, to identify the main adjustments that could distort the indicator and drop them for the definition, whichever is easier, divided by the sum of external funding (instead of total liabilities). Moreover, as it is recognised in the paper (paragraph 33) there are the “short term liquid liabilities” which could be a source of systemic risk. Thus consideration should

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be given to excluding medium and long term wholesale funding from this indicator.

Our understanding is that the interconnectedness indicators refer to positions against third parties and do not include intra group exposures, but it should be worth to make this explicit in the paper.

We also consider that **supervisory judgement** should take into account some **qualitative aspects** of systemic risk, such as governance policies, organizational and business model, and quality of management (discretionality could be avoided because for many of these there are already best practices set at international level that could be used as a reference for assessment and could also be subject to peer reviews). In our view the currently proposed ancillary indicators do not fully capture these aspects and, to some extent, duplicate the main indicators on the quantitative side.

Especially important in this context is the **resolvability** of an institution. We consider that a credible crisis management framework, one that allows for orderly failure of any bank by imposing failures to all creditors without putting taxpayer money at risk, is the key to reducing moral hazard and hence systemic risk and therefore to recovering market discipline.

Hence, resolvability as a new criterion should be clearly included when assessing the systemic risk of a financial institution, and determining the capital surcharge to be imposed. This will provide the right incentives for the institutions to increase their resolvability.

Although it could be considered difficult or even impossible to include resolvability at this point in time if objective and comparable measurement is requested, an analysis carried out by Oliver Wyman[1] at Santander's request provides evidence that:

1) A reasonable proxy of the cost of failure could be obtained based on public information.

2) There is a clear "*tiering*" of cost of failure, suggesting that a graduated approach is needed when shaping any policy measure.

3) Key explanatory variables of cost of failure (such as concentration of operations, interdependence and soundness of subsidiary operations and ability to absorb losses) are not included in the proposed methodology and we believe they could complement this approach.

In this regard we strongly support the efforts of the FSB to establish clear and objective criteria to assess the resolvability of an institution.

[1] The report is available on request at the following address: publicpolicy@gruposantander.com

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An additional important question that we consider needs further clarification is how **consolidated and local requirements** would play out, i.e., the application of the systemic surcharge on an individual basis on top of the consolidated basis. The resulting framework should not result in a more favourable treatment for groups organized in branches than for those organised around subsidiaries. The organization around subsidiaries has proved to have advantages from a resolution viewpoint that, if not fully recognised, should be at least not unduly penalised. The interaction between the local and consolidated requirements and the role of the colleges in this process deserves further reflection. Especially important is that the home supervisor plays a leadership role in the college that ensures proper coordination. For global banks organized as subsidiaries the application of consolidated (if considering a G-SIB) and local requirements (if identified as a L-SIFI and a surcharge imposed) without a proper coordination could result in an unjustified overburden that penalizes this structure.

In addition, it would be odd that in some jurisdictions surcharges on local SIFIs result to be higher than surcharges on G-SIFIs due to stringent local requirements. Consistency of the whole G-SIFIs-Local SIFIs regimes is necessary to ensure the credibility of whole framework. Finally, the implementation of the requirements for G-SIFIs and Local SIFIs should be coordinated in content and timing to avoid adding uncertainty and confusion to a process that, in any case, will not be easy to carry out.

Finally, an important point that deserves further analysis and elaboration relates to the extent, the frequency and the timeline of disclosure of the list of Systemically Important Institutions and the scores/buckets/surcharges resulting for each institution. We think that the request to disclose all this information should be done on an annual basis and for all financial institutions, not only for those included in the G-SIBs list, as this will change over time.

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