Santander

SANTANDER RESPONSE TO BASEL COMMITTEE ON BANKING SUPERVISION CONSULTATIVE DOCUMENT ON DOMESTIC SYSTEMICALLY IMPORTANT BANKS (D-SIBs)

I. Introduction

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 recover market confidence. Curbing moral hazard and reducing systemic risk is instrumental in this regard. However, as we have already stated in the context of the Global Systemic institutions debate, we think that additional capital buffers based on a metric of an institution´s systemic importance is not the best way to deal with these problems. An enhanced macro prudential framework, that reduces the probability of the build-up of systemic risk, together with an effective crisis management framework that reduces the impact of a potential institution failure, are more effective in addressing moral hazard and systemic risk problems.

Nonetheless, we welcome the introduction of a D-SIBs framework that ensures a minimum level of convergence across jurisdictions when imposing requirements to domestic systemically important institutions. This convergence is essential to ensure a level playing field and is especially important for cross border banking groups that are subject to different national regulatory requirements.

We appreciate the proposal attempt to be consistent with the G-SIBs framework through, for instance, the recommendation to use the same indicators, the reference to the Basel quantitative methodology to determine the minimum level of loss absorbency and the alignment in the timetable of both requirements and the phase in period. However, we think that there is still too much room for divergent national approaches and thus consider that the framework should ensure further harmonization.

Our major concern with the draft is the proposal to measure the systemic importance of an institution by the home authorities using the consolidated balance sheet of the group regardless of its organizational structure. In this respect, the model of standalone subsidiaries is not recognised in the draft as a model that reduces contagion among the different parts of the group. We think that for a group organized in standalone subsidiaries the balance sheet that is relevant to measure the degree of systemic importance in the home country is the parent balance sheet and not the consolidated one. Content of Recovery and Resolution Plans (RRPs) regarding mitigating factors (i.e. organizational structure, firewalls and/or local funding), should also be considered by national authorities in this framework. National supervisors should take into account the information provided in the RRPs to evaluate how resolvable an institution is and the risk of intragroup contagion. This assessment should be considered when determining the systemic importance of an institution both at group and at individual level.

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Finally, for cross border groups that could be deemed systemic in several jurisdictions **coordination within the colleges of supervisors is crucial** to ensure a consistent approach to D-SIBs and avoid the overburden that otherwise cross border institutions could face. Further harmonization in the requirements and consistency between the G-SIBs framework and the D-SIBs frameworks would make easier the necessary coordination within the colleges.

II. Santander Position on specific issues

Santander agrees on the introduction of a D-SIBs framework to create a level playing field. From a global entity standpoint, it is preferable to develop this framework in an international manner. Thus, avoiding local applications which could be divergent and uncoordinated. Santander was concerned about divergent local initiatives that could undermine the global agreements. A level playing field should be created among supervisors, avoiding different treatment of similar risks regardless of the country where the institution operates. If cross-border externalities are the rationale behind the G-SIBs framework, the extension of a similar framework to domestic systemic institutions is the natural one to achieve a level playing field.

We welcome the aim to make the D-SIBs framework consistent with the G-SIBs framework. In particular the suggestion to introduce the same indicators, methodology, timetables and phase-in period as in G-SIBs. For global groups that could be deemed systemic in several jurisdictions the compliance with non-harmonized prudential framework is always an overburden and a source of complexity both for the institution management and for market analysis.

Although we have concerns on specific G-SIBs framework indicators, we fully agree with the introduction of a broad set of criteria to identify systemic risk and thus we think this approach should be encouraged in the D-SIBs framework. The contribution to systemic risk of each institution is driven by various risk factors embedded in multiple groups of variables. A prudential policy based on a single variable or 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 allows to take into account systemic risk not captured by other indicators. However, we think that the room for discretion should be reduced in order to have a minimum level of convergence. Otherwise it could be difficult for cross border groups to manage the group attending to uncoordinated and even contradictory incentives introduced by the different regulators.

With respect to the determination of the additional level of loss absorbency, we think that for G-SIBs that are also considered systemic in the home jurisdiction the additional local buffer should never be above the global buffer. The damage that an institution could pose in a local economy by its failure cannot be higher than the damage that the failure of an institution could pose to the global system. Thus, if the

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additional global buffer is enough to address the global systemic impact no need for additional buffer at local level should be needed to address the local systemic impact. The allocation of G-SIBs buffer by geographies could be an option.

Finally, the alignment of the implementation schedule with the G-SIBs framework is reasonable, thus avoiding uncertainty, confusion and disadvantages among international and local players.

Measuring the degree of importance of an institution as a consolidated group is a major concern for Santander. For global banks organized as subsidiaries the application of consolidated (if considering a G-SIB) and local requirements (if identified as a D-SIB) would result in an unjustified overburden that penalizes this structure. The organization around subsidiaries has proven to:

- Have advantages from a resolution viewpoint that, if not fully recognized, should be at least not unduly penalized. Both subsidiary models and resolution schemes reduce severity and have implicit costs that are not rewarded in the prudential framework.
- Reduce moral hazard in the management of the subsidiaries, as the bail out from parent company is less probable than in the case of the branching model[1].
- Create less systemic risk, as firewalls between subsidiaries and parent prevents from waterfall risks and increase modularity in the system. Both firewalls and modularity reduce severity, and have been appointed recently as catalysts to the strength and stability of the financial system[2].

We consider all of these characteristics as mitigation factors that shall be embedded in any framework based on severity. Consequently, D-SIBs framework should take into account the organizational structure of banking groups:

a) For groups in which overseas operations are organized in branches (thus, without a legal entity in the host country and belonging to the parent) the banking group resolution and associated costs will be afforded by home country authorities. By definition, in this model a branch is not allowed to fail if the parent company does not fail. It is true that the failure of a banking group organized in branches that are locally systemic could have an impact in other economies in case that the group resolution is not carried in an orderly manner.

b) For groups organized in standalone subsidiaries the banking group resolution and associated costs involve several countries. Thus, in case of failure the costs are shared among several Deposit Guaranteed Schemes (DGS) and each subsidiary has to resort to a central bank in order to obtain liquidity support.

[1] Fiechter, J., Ötker-Robe, I., Ilyina, A., Hsu, M., Santos, A., Surti, J.,2011," Subsidiaries and Branches: Does One Size Fit All? IMF.
[2] Haldane, A., May, R, 2012, "Systemic risk in banking ecosystems", Nature
Haldane, A., 2009, "Rethinking the financial network", Bank of England

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We think that the standalone subsidiary model has advantages both in terms of reducing the probability of failure by introducing the right incentives at all levels; and by reducing the impact of the failure because of firewalls that minimize contagion and complexity of the organization. All these issues facilitate resolution, thereby leading to take into account only the domestic balance sheet in the home country instead of the consolidated one.

Recovery and resolution plans should be considered in the D-SIBs framework. Recovery and resolution plans should be taken into account in order to assess the systemic importance of an institution. Moreover, RRPs at level group should be used to determine the degree of interconnectedness among the group, and therefore in order to determine the appropriate balance sheet that should be taken into account at home level.

Extent, frequency and timeline of disclosure of the list of D-SIBs deserve further analysis and elaboration. Institutions and the scores/buckets/surcharges resulting for each institution also require a sufficient observational period to analyze potential unintended consequences and conclude that is the appropriate path to deal with systemic risk. We think that the disclosure requirements should be done on an annual basis and for all financial institutions, not only those included in each D-SIBs list, as this list will change over time.

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