

May 15, 2017

Via Electronic Mail

Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel Switzerland

Re: Consultative Document – Guidelines – Identification and Management of Step-In Risk (March 2017)

Ladies and Gentlemen:

The Clearing House Association L.L.C.¹ appreciates the opportunity to comment on the Basel Committee on Banking Supervision's second Consultative Document proposing guidelines for a framework to identify and manage step-in risk. The Basel Committee has defined step-in risk as "the risk that a bank decides to provide financial support to an unconsolidated entity that is facing stress, in the absence of, or in excess of, any contractual obligations to provide such support."² Although we agree that step-in risk is an appropriate focus of banks³ and their supervisors and we support the Basel Committee's decision to fundamentally revise its earlier proposed framework with respect to step-in risk,⁴ we believe there are numerous aspects of the proposed guidelines that require clarification and revision to achieve the Basel Committee's objectives of sensitivity to residual step-in risk and simplicity of the framework.⁵

¹ The Clearing House is a banking association and payments company that is owned by the largest commercial banks and dates back to 1853. The Clearing House Association L.L.C. is a nonpartisan organization that engages in research, analysis, advocacy and litigation focused on financial regulation that supports a safe, sound and competitive banking system. Its affiliate, The Clearing House Payments Company L.L.C., owns and operates core payments system infrastructure in the United States and is currently working to modernize that infrastructure by building a new, ubiquitous, real-time payment system. The Payments Company is the only private-sector ACH and wire operator in the United States, clearing and settling nearly \$2 trillion in U.S. dollar payments each day, representing half of all commercial ACH and wire volume.

² Consultative Document, at para. 14.

³ The term "bank" is used throughout this letter to include a bank holding company.

⁴ See The Clearing House, *Comment Letter Re: Identification and Measurement of Step-in Risk – Consultative Document dated December 2015* (Mar. 17, 2016), available at <https://www.theclearinghouse.org/sitecore/content/tch/home/issues/articles/2016/03/20160317-tch-comments-to-basel-on-step-in-risk>.

⁵ See Consultative Document, at para. 3.

I. Executive Summary

- Any final guidelines should provide that national supervisors are required to analyze the extent to which post-crisis regulatory reforms and other mechanisms have mitigated step-in risk to determine both whether there is any residual step-in risk that warrants implementation of the Basel Committee's framework and, if so, how such implementation should be effected.
- The Basel Committee should clarify and, in some cases, revise (i) the relationships with unconsolidated entities that bring entities in-scope for evaluation, (ii) the specific types of unconsolidated entities that are excluded from analysis and the treatment of the Basel Committee's counterexamples of step-in risk indicators, and (iii) the identification of collective rebuttals. In addition, to promote the simplicity of the proposed framework, the Basel Committee should clarify that top-tier entities should evaluate step-in risk on a consolidated basis and that banks would not be subject to the framework at multiple levels.
 - The Basel Committee should (i) revise the definition of sponsor so that it does not require banks to evaluate entities that do not present step-in risk and (ii) clarify that a bank would not be an "important investor" in an unconsolidated entity's debt or equity instruments due to passive investments or debt investments held in the trading book.
 - The Basel Committee should (i) exclude the asset management entities presented as counterexamples in the Consultative Document from a bank's step-in risk analysis and (ii) permit national supervisors to exclude additional specific types of unconsolidated entities from additional analysis of residual step-in risk by banks if the national supervisors determine that regulatory reforms and other mechanisms have already addressed step-in risk relating to those entities.
 - To promote the consistent application of the collective rebuttal approach across banks within each jurisdiction, the Basel Committee should clarify that national supervisors are expected to provide guidance regarding which laws or regulations qualify as collective rebuttals in their respective jurisdictions.
 - The proposed framework should apply to only top-tier entities on a consolidated basis.
- The Basel Committee should revise the guidelines so that national supervisors have the flexibility to use, not use or revise the proposed reporting templates. Additionally, the Basel Committee should revise the proposed templates so that they would not require banks to report irrelevant information or information already reported to supervisors and appropriately balance the administrative burdens of reporting the additional information as compared against the purported supervisory benefits to be derived from such reporting.

II. Any final guidelines should provide that national supervisors are required to analyze the extent to which post-crisis regulatory reforms and other mechanisms have mitigated step-in risk to determine both whether there is any residual step-in risk that warrants implementation of the Basel Committee’s framework and, if so, how such implementation should be effected.

As recognized in the Consultative Document, regulatory and accounting reforms have already been implemented in a number of jurisdictions that substantially mitigate step-in risk and “even eliminate step-in risk in certain cases”.⁶ We believe that in some jurisdictions, including the United States, accounting standards post-crisis regulatory reforms and other mechanisms have virtually eliminated step-in risk. In those jurisdictions, there is not any residual step-in risk that warrants the application of the guidelines’ “structured approach,” which “is designed to create a safety net to inform and supplement”⁷ post-crisis regulatory reforms and other mechanisms that have already addressed step-in risk. Accordingly, we respectfully urge the Basel Committee to clarify and revise the proposed guidelines to avoid imposing disproportionate and undue administrative and compliance burdens on banks in those jurisdictions without any counterbalancing risk mitigation or supervisory benefits.

The Consultative Document acknowledges the importance of sensitivity to residual step-in risk with regard to the overall design of the proposed framework, banks’ own self-assessments of step-in risk, and supervisors’ reviews of banks’ self-assessments.⁸ The Consultative Document is nevertheless fundamentally insensitive to *residual* step-in risk as it appears to contemplate that each and every jurisdiction would implement the proposed framework, irrespective of the degree to which—or even whether—any step-in risk continues to actually be present in the jurisdiction. To the extent there is sufficient variation among jurisdictional mechanisms addressing step-in risk, the Basel Committee may deem it necessary to provide guidance with respect to step-in risk in order to achieve consistency across jurisdictions. However, that variation does not make it appropriate for a jurisdiction to implement a framework to identify and manage risks that essentially no longer exist in the jurisdiction.

Indeed, where, as in the United States, step-in risk has been virtually eliminated through post-crisis regulatory reforms and other mechanisms, the implementation of the proposed framework would require banks to devote resources to administrative and compliance exercises that would not actually mitigate any risk or provide any supervisory benefit.

We therefore recommend that the Basel Committee revise the proposed guidelines to make clear that national supervisors should not automatically implement the Basel Committee’s framework in their respective jurisdictions. Rather than contemplating automatic implementation in each and every jurisdiction, the guidelines should provide that national supervisors are expected to first analyze what, if any, residual step-in risk continues to actually be present in their jurisdictions, after taking into account the full range of post-crisis reforms and

⁶ See *id.*, at paras. 4-11.

⁷ See *id.*, at para. 12.

⁸ See, e.g., *id.*, at paras. 3, 67 and 101.

other mechanisms that have already addressed step-in risk. If national supervisors determine that residual step-in risk continues to be present in their jurisdictions, they should then be expected to evaluate whether the extent of such residual step-in risk makes it appropriate to implement the Basel Committee’s framework in their jurisdictions, taking into account whether the benefits of implementing the framework would outweigh the administrative and compliance burdens the framework would impose on banks. Finally, if national supervisors determine that residual step-in risk warrants implementing the framework, they should have the flexibility to do so in the manner they consider appropriate. For example, where step-in risk has been substantially mitigated, appropriate implementation could be accomplished through supplementing existing supervisory and examination processes and need not be achieved through formal guidance or rulemaking. Only *after* national supervisors determine what, if any, framework should be utilized in their respective jurisdictions to address residual step-in risk would banks in such jurisdiction be required to conduct any additional step-in risk analysis with respect to unconsolidated entities.

We believe that if U.S. consolidation standards and post-crisis regulatory reforms (as described below)⁹ are considered, it is clear that the Basel Committee’s rationale for its framework—that it “will *usefully* supplement the existing building blocks in providing a detailed identification method for step-in risk”¹⁰—does not apply to the United States. Moreover, such consolidation standards and post-crisis regulatory reforms are forward-looking and designed not only to eliminate past examples of step-in risk but also to do so for “situations where step-in risk . . . needs to be anticipated.”¹¹ Rather than acting “as a safety net for the situation where step-in risk may remain, emerge or re-emerge,”¹² the Basel Committee’s framework would needlessly require banks to comply with duplicative risk identification and management requirements that would not mitigate any actual risk or provide any supervisory benefit.

- Consolidation standards. The consolidation requirements under U.S. generally accepted accounting principles are used to identify which entities are consolidated for accounting and regulatory purposes, as the same basis of consolidation is used for both. These requirements address when a reporting entity—such as a bank—holds an implicit variable interest in a variable interest entity.¹³ An implicit variable interest

⁹ These standards and reforms have all been adopted and, in almost all cases, already entered into force. U.S. regulators have proposed additional reforms that would serve as further mitigants to step-in risk, such as the Securities and Exchange Commission’s proposal on derivatives and financial commitments for registered investment companies and business development companies. See SEC, *Use of Derivatives by Registered Investment Companies and Business Development Companies* (File No. S7-24-15). Moreover, certain U.S. legal and regulatory constraints that pre-date the financial crisis also act as mitigants to step-in risk, such as the lending limits applicable to U.S. depository institutions (see, e.g., 12 U.S.C. 84; 12 C.F.R. Part 32), and the limitations on U.S. depository institutions’ transactions with affiliates under the Federal Reserve’s Regulation W and Sections 23A and 23B of the Federal Reserve Act, which generally treat sponsored funds as bank affiliates for purposes of these limitations (see 12 U.S.C. §§ 371c and 371c-1; 12 C.F.R. Part 223).

¹⁰ Consultative Document, at para. 4 (emphasis added).

¹¹ *Id.*, at para. 2.

¹² *Id.*, at para. 3.

¹³ Accounting Standards Codification (ASC) 810-10-25-49 to -54.

involves absorbing and/or receiving variability indirectly from another entity. For example, an implicit variable interest may exist if a reporting entity can be required to protect an investor in another entity from absorbing losses incurred by that other entity. A reporting entity is required to consider whether it has an implicit variable interest in another entity when determining whether it is required to consolidate that other entity. Such accounting analysis subsumes step-in risk considerations. For example, a bank would not conclude both that it does not have an implicit variable interest (and, correspondingly, need not consolidate a variable interest entity) yet also has significant step-in risk to that entity such that it would need to take action under the Basel Committee's framework. Relatedly, if the bank concluded that it did have an implicit variable interest and was required to consolidate an entity, then the entity would be wholly outside the step-in risk framework, which focuses only on supporting unconsolidated entities. Accordingly, even as revised, the Basel Committee's framework would overlap with the very same considerations that U.S. banks must already take into account when determining whether an entity should be consolidated.

- Identification and management of off-balance-sheet risks. The United States has already developed a framework that supplements Basel III capital and liquidity requirements and is designed to result in the appropriate identification, consideration and management of off-balance-sheet risks, including step-in risk. In the Federal Reserve's CCAR process, which is conducted in connection with related supervisory and company-run stress tests, banks participating in CCAR¹⁴ must identify and assess risks to which they are exposed, and the assessment must cover, among other things, off-balance-sheet exposures and "risks that only materialize or become apparent under stressful conditions."¹⁵ In connection with its CCAR process, the Federal Reserve has also implemented the reporting form FR Y-14A, which requires banks that participate in CCAR to report a number of off-balance-sheet items.¹⁶ Form FR Y-14A also provides that those banks must document how they "(i) identified unconsolidated entities and sponsored products to which the [bank] has potential exposure, (ii) evaluated those entities / sponsored products under stressed scenario conditions, and (iii) projected and reported any associated financial losses – whether in the form of non-contractual support or reflected elsewhere in [pre-provision net

¹⁴ Top-tier U.S. bank holding companies with total consolidated assets of \$50 billion or more and U.S. intermediate holding companies of foreign banking organizations participate in CCAR. See 12 C.F.R. § 225.8(b).

¹⁵ Federal Reserve, *Federal Reserve Supervisory Assessment of Capital Planning and Positions for LISCC Firms and Large and Complex Firms*, SR 15-18 (Dec. 18, 2015), at 6, available at https://www.federalreserve.gov/bankinfo/srletters/sr1518_PW.pdf; Federal Reserve Board, *Federal Reserve Supervisory Assessment of Capital Planning and Positions for Large and Noncomplex Firms*, SR 15-19 (Dec. 18, 2015), at 6, available at https://www.federalreserve.gov/bankinfo/srletters/sr1519_PW.pdf.

¹⁶ See Federal Reserve, *Instructions for The Capital Assessments and Stress Testing information collection (Reporting Form FR Y-14A)* (version as of Feb. 28, 2017), available at https://www.federalreserve.gov/reportforms/forms/FR_Y-14A20161231_i.pdf.

revenue] (e.g., foregone revenue).”¹⁷ The identification, assessment and reporting of these risks in the CCAR process, and the requirement that banks participating in CCAR hold appropriate amounts of capital against these and other risks under a variety of stress scenarios, address the objectives the Basel Committee’s proposed framework is meant to achieve.

- Governance mechanisms. In connection with the Federal Reserve’s CCAR process and in response to supervisory guidance,¹⁸ banks have developed governance processes to identify, consider and limit the potential for implicit obligations outside contractual arrangements.
- Asset management reforms. The Securities and Exchange Commission has finalized rules that virtually eliminate step-in risk with respect to money market mutual funds by requiring certain money market mutual funds to sell and redeem shares based on a floating NAV, as opposed to a stable \$1 per share NAV, and by allowing boards of directors of money market mutual funds to impose liquidity fees and redemption gates.¹⁹ The SEC has also finalized rules requiring open-end mutual funds and exchange traded funds to adopt and implement liquidity risk management programs,²⁰ which virtually eliminate step-in risk relating to these funds. In addition, the SEC has finalized rules that, beginning in November 2018, will permit open-end mutual funds to institute swing pricing,²¹ which virtually eliminate step-in risk relating to first-mover incentives.
- Liquidity requirements. As recognized in the Consultative Document, various provisions of the liquidity coverage ratio address step-in risk.²² Consistent with the Basel Committee’s revised 2013 LCR framework, the outflow components in the U.S. LCR “take into account the potential impact of idiosyncratic and market-wide shocks, including those that would result in . . . the potential need for a covered company . . . to honor non-contractual obligations in order to mitigate reputational and other risks.”²³ The U.S. LCR is supplemented by liquidity risk management and

¹⁷ *Id.*, at 209-210. Banks must include this documentation with their annual capital plan submissions if they have total consolidated assets of \$250 billion or more or total nonbank assets of \$75 billion or more. Other banks participating in CCAR must provide this documentation to the Federal Reserve upon request. See *id.*, at 193.

¹⁸ See, e.g., Federal Reserve, *Risk Transfer Considerations When Assessing Capital Adequacy – Supplemental Guidance on Consolidated Supervision Framework for Large Financial Institutions* (SR letter 12-17/CA letter 12-14), SR 13-23 (Dec. 20, 2013), available at <https://www.federalreserve.gov/bankinfo/reg/srletters/sr1323.pdf>.

¹⁹ SEC, *Money Market Fund Reform; Amendments to Form PF*, 79 Fed. Reg. 47736 (Aug. 14, 2014).

²⁰ SEC, *Investment Company Liquidity Risk Management Programs*, 81 Fed. Reg. 82142 (Nov. 18, 2016).

²¹ SEC, *Investment Company Swing Pricing*, 81 Fed. Reg. 82084 (Nov. 18, 2016).

²² See Consultative Document, at para. 7.

²³ OCC, Federal Reserve and FDIC, *Liquidity Coverage Ratio: Liquidity Risk Measurement Standards*, 79 Fed. Reg. 61440, at 61444 (Oct. 10, 2014).

stress testing requirements under the Federal Reserve’s enhanced prudential standards,²⁴ and, for banks subject to the Federal Reserve’s Large Institution Supervision Coordinating Committee framework, the Federal Reserve’s annual, horizontal, forward-looking program to evaluate the liquidity position and liquidity risk management practices of those banks, referred to as the Comprehensive Liquidity Analysis and Review or CLAR.²⁵ In addition, the Federal Reserve’s reporting form FR 2052a requires large U.S. banks to discuss with their supervisors “[a]ny material conduits or special purpose entities (SPEs) that are not consolidated under GAAP . . . to ensure that the liquidity risk of those entities is properly addressed” and to report projected outflows related to entities that the Basel Committee’s framework would require banks to scrutinize, including conduits and SPEs used in connection with covered bonds, tender offer bonds and asset-backed commercial paper, as well as any material cash outflows not otherwise required to be reported that can impact the liquidity of the reporting bank.²⁶

- **Volcker Rule.** As the Basel Committee has observed, the Volcker Rule provides “a great deal of mitigation against step-in risk”²⁷ because it regulates relationships between a bank and covered funds that are sponsored and/or advised by the bank and generally prohibits a bank from stepping in to support such covered funds.²⁸

In light of the forward-looking U.S. mechanisms, including consolidation standards and post-crisis regulatory reforms, it is clear that the United States would not benefit from the implementation of the proposed framework: consolidation standards under U.S. GAAP require banks to consider the same risks meant to be addressed by the proposed framework’s analysis, the United States has implemented reforms that virtually eliminate step-in risk with regard to many types of asset management entities, the robust U.S. framework for liquidity regulation and supervision addresses step-in risk, and, moreover, the Federal Reserve’s CCAR process effectively acts as a backstop by requiring banks to identify and capitalize residual step-in risk, if any, under a severely adverse economic scenario.

III. The Basel Committee should clarify and, in some cases, revise (i) the relationships with unconsolidated entities that bring entities in-scope for evaluation, (ii) the specific types of unconsolidated entities that are excluded from analysis and the treatment of the Basel Committee’s counterexamples of step-in risk indicators, and

²⁴ See 12 C.F.R. §§ 252.34 and 252.35.

²⁵ See, e.g., Federal Reserve, *Governance Structure of the Large Institution Supervision Coordinating Committee (LISCC) Supervisory Program*, SR 15-7 (Apr. 17, 2015), at 4, available at <https://www.federalreserve.gov/bankinfo/srletters/sr1507.pdf>.

²⁶ Federal Reserve, *Complex Institution Liquidity Monitoring Report*, FR 2052a, at 2, 31 and 49, available at https://www.federalreserve.gov/reportforms/forms/FR_2052a20161231_f.pdf

²⁷ Basel Committee – *Consultative Document – Identification and measurement of step-in risk* (Dec. 2015), at sections 1.2.3 and 5.2, available at <https://www.bis.org/bcb/pubs/publ/d349.pdf>.

²⁸ See 12 U.S.C. § 1851(f); see also section 14(a) of the regulations adopted by the Federal Reserve, OCC, FDIC, SEC and CFTC implementing the Volcker Rule (12 C.F.R. § 248.14(a); 12 C.F.R. § 44.14(a); 12 C.F.R. § 351.14(a); 17 C.F.R. § 255.14(a); 17 C.F.R. § 75.14(a)).

(iii) the identification of collective rebuttals. In addition, to promote the simplicity of the proposed framework, the Basel Committee should clarify that top-tier entities should evaluate step-in risk on a consolidated basis and that banks would not be subject to the framework at multiple levels.

Under the Basel Committee’s proposed framework, banks would conduct a five-stage self-assessment of step-in risk, which would be subject to supervisory review.²⁹ First, a bank would determine which unconsolidated entities should be evaluated for potential step-in risk, taking into account their relationships with the bank. Second, a bank would exclude immaterial entities and entities subject to collective rebuttals from the step-in risk analysis. Third, a bank would assess the remaining entities for potential step-in risk, taking into account relevant step-in risk indicators and mitigants. Fourth, for entities presenting step-in risk, a bank would estimate the potential impact of stepping in to provide support to the entities and, where step-in risk is significant, determine the appropriate response to mitigate that risk. Finally, a bank would report its self-assessment to its supervisor using standardized templates. We believe the clarifications and revisions described below would promote the proposed framework’s sensitivity to residual step-in risk after considering all reforms, as well as its simplicity.

A. The Basel Committee should (i) revise the definition of sponsor so that it does not require banks to evaluate entities that do not present step-in risk and (ii) clarify that a bank would not be an “important investor” in an unconsolidated entity’s debt or equity instruments due to passive investments or debt investments held in the trading book.

The first step in a bank’s self-assessment of residual step-in risk would be to identify entities with which it has one or more relationships as sponsor, debt or equity investor, or other contractual and non-contractual involvement.³⁰ The relationships that bring unconsolidated entities in-scope for evaluation are overly broad.

- Sponsorship: underwriting and placing securities into the market. The definition of “sponsor” includes entities for which the bank “places the entity’s securities into the market,”³¹ which would mean that any underwriter, initial purchaser or placement agent would be a “sponsor” for purposes of the Basel Committee’s framework. Such a broad definition would capture relationships that could not conceivably present step-in risk. Under the framework, a bank would be expected to scrutinize a variety of types of entities for potential step-in risk,³² and if, for example, a bank acted as a junior co-manager (i.e., a secondary underwriter) with a small allocation in a securities offering for such an entity, that relationship alone would be sufficient to require the bank to evaluate the entity for step-in risk. It is inconceivable for a bank to have reputational concerns that could give rise to step-in risk as a result of only that

²⁹ See Consultative Document, at section 1.4.

³⁰ See *id.*, at para. 24.

³¹ *Id.*

³² See *id.*, at Annex 2.

relationship. Nevertheless, the proposed framework would treat that relationship as sufficient to bring that entity in scope for evaluation.

- Sponsorship: managing and advising. The definition of “sponsor” includes entities that the bank “manages or advises.” Such a broad definition would capture any and all relationships between a bank and sponsored funds, including, again, relationships that could not realistically present step-in risk. For example, a bank merely acting as an investment adviser for an otherwise unaffiliated U.S. mutual fund would be a “sponsor” for purposes of the Basel Committee’s framework. Here too, the Basel Committee’s framework would treat a relationship as sufficient to bring an entity in scope for evaluation even though it is inconceivable for a bank to have reputational concerns that could give rise to step-in risk as a result of that relationship.
- Investing relationships. The proposed framework notes that entities for which a bank “is an important investor in [the entities’] debt or equity instruments”³³ should be evaluated for step-in risk. While we agree that investing relationships can, in certain circumstances, be an indicator of potential step-in risk, there are also investing relationships that would not give rise to step-in risk, such as passive investments. In addition, debt investments that arise from market-making do not present any greater step-in risk than the equity investments held in a trading book, which, as the Basel Committee has already properly noted, should be excluded from the analysis. Accordingly, we believe that the Basel Committee should clarify that a bank with a passive investment or any investment (whether equity or debt) held in the trading book would not, on account of that investment, be an “important investor” in an unconsolidated entity’s debt or equity instruments for purposes of the framework.

B. The Basel Committee should (i) exclude the asset management entities presented as counterexamples in the Consultative Document from a bank’s step-in risk analysis and (ii) permit national supervisors to exclude additional specific types of unconsolidated entities from additional analysis of residual step-in risk by banks if the national supervisors determine that regulatory reforms and other mechanisms have already addressed step-in risk relating to those entities.

Under the Basel Committee’s proposed framework, certain unconsolidated entities need not be evaluated for step-in risk. We strongly agree with the Basel Committee that certain entities should be excluded from a bank’s residual step-in risk analysis; however, we believe the categorical exclusions are too narrow, excluding only insurance entities, commercial entities and operational service providers, and entities subject to collective rebuttals from the scope of the proposed step-in risk framework.³⁴

³³ *Id.*, at para. 24.

³⁴ *See id.*, at paras. 25-31; *see also id.*, at Annex 1 (“Entities outside the scope of the step-in risk framework should not be reported. These entities are insurance and regulated banking entities, entities subject to collective rebuttals and entities that do not meet the relationship criteria described in Section 2.2.3.”).

In its discussion of indicators that banks should use to identify residual step-in risk, the Consultative Document provides examples of entities anticipated to potentially present step-in risk, as well as counterexamples, including, among others, index funds, ETFs, funds with floating/variable NAVs, funds with the ability to impose redemption gates and pass-through securitizations.³⁵ We believe that the asset management counterexamples do not present any greater residual step-in risk than the specific types of entities that the Basel Committee has already excluded from analysis, and excluding those entities presented as counterexamples from a bank's residual step-in risk analysis would promote both the framework's sensitivity to residual step-in risk as well as its simplicity. Thus, we recommend that the Basel Committee revise the proposed guidelines to exclude such entities from a bank's step-in risk analysis.

In addition, as discussed above with regard to U.S. consolidation requirements, in some cases existing mechanisms already cover the considerations the Basel Committee's framework would require banks to take into account. Banks should not be required to analyze unconsolidated entities for potential step-in risk where another mechanism requires banks to identify, consider and where appropriate, respond to the factors that could give rise to potential residual step-in risk. For example, where U.S. GAAP requires a bank to determine whether it holds an implicit variable interest in another entity and the bank determines that it does not, an additional assessment under the Basel Committee's framework would be duplicative, amounting to a needless administrative and compliance burden. Similarly, an assessment of an entity under the Basel Committee's framework would be altogether unnecessary in the event a bank commits to its supervisors that it will not step-in to support such entity, which certain banks may do in connection with recovery or resolution planning or other regulatory or risk management exercises.

Accordingly, we further recommend that the Basel Committee revise the proposed guidelines to provide that national supervisors have the flexibility to exclude other unconsolidated entities from the residual step-in risk analysis if the national supervisors determine that any residual step-in risk relating to those entities has already been considered, and where applicable, appropriately mitigated.

C. To promote the consistent application of the collective rebuttal approach across banks within each jurisdiction, the Basel Committee should clarify that national supervisors are expected to provide guidance regarding which laws or regulations qualify as collective rebuttals in their respective jurisdictions.

Under the proposed framework, entities subject to collective rebuttals are excluded from a bank's step-in risk analysis. The Consultative Document provides that laws and regulations must "explicitly prohibit" the provision of support and be "clearly enforceable" and "of general application" to be considered collective rebuttals.³⁶ In their policies and procedures, banks are expected to specify the types of entities subject to collective rebuttals and the specific provisions

³⁵ See, e.g., *id.*, at para. 48.

³⁶ See *id.*, at para. 30.

of laws or regulations that qualify as collective rebuttals.³⁷ We believe it would be beneficial if national supervisors provided guidance regarding which laws or regulations qualify as collective rebuttals in their respective jurisdictions. Such guidance would promote the consistent application of the collective rebuttals approach in each jurisdiction, ease the burdens on banks in determining which laws or regulations can be considered collective rebuttals, and clarify supervisory expectations in connection with supervisory assessments of banks' application of the collective rebuttal approach.³⁸

D. The proposed framework should apply to only top-tier entities on a consolidated basis.

The Consultative Document does not address how the proposed framework would apply to banking organizations that have both a top-tier entity and subsidiaries subject to prudential regulatory requirements, such as a bank holding company that has one or more bank subsidiaries. We believe the framework should apply to only the top-tier entity on a consolidated basis. Because step-in risk relates to the provision of support to unconsolidated entities, conducting the self-assessment on a consolidated basis at only the level of the top-tier entity would result in the appropriate identification, consideration and mitigation of any significant residual step-in risk to which a banking organization is exposed. Subjecting lower-tier entities to the framework would merely introduce redundancy in self-assessment processes without providing incremental mitigants or supervisory benefits. Accordingly, the Basel Committee should clarify that the framework would apply to only the top-tier entity on a consolidated basis, and that lower-tier entities—whether or not directly subject to prudential regulation—need not conduct the self-assessment contemplated by the framework.

IV. The Basel Committee should revise the guidelines so that national supervisors have the flexibility to use, not use or revise the proposed reporting templates. Additionally, the Basel Committee should revise the proposed templates so that they would not require banks to report irrelevant information or information already reported to supervisors and appropriately balance the administrative burdens of reporting the additional information as compared against the purported supervisory benefits to be derived from such reporting.

The proposed guidelines include standardized reporting templates that would require banks to provide information on all unconsolidated entities that are not treated as outside the scope of the step-in risk framework, including immaterial entities. We are concerned that the proposed templates insufficiently balance the costs of collecting many of the proposed data elements with the effective marginal supervisory benefits to be derived from analyzing such elements, particularly since the proposed reporting templates would require the reporting of broad but ultimately irrelevant or duplicative information and, in certain jurisdictions including the United States, the templates would overlap with information that banks already provide

³⁷ See *id.*, at paras. 30 and 91.

³⁸ See *id.*, at para. 98 (“Supervisors are expected to review banks’ policies or procedures to ensure that banks have conducted appropriate self-assessment of the eligible collective rebuttal presumptions, including the appropriate interpretation and application of relevant laws and regulations.”).

separately to their supervisors. Current processes, procedures and controls would also need to be revised to satisfy these requirements. Banks would need to devote disproportionate management attention and information technology time and expense to the development and maintenance of systems and new data collection processes that would be required in order to obtain the level of detail requested and present the information in standardized supervisory templates, thereby creating significant opportunity costs by diverting important resources from other applicable regulatory and management requirements. The proposed templates thus fail to reflect an overarching and foundational principle that should inform any reporting requirement: management attention and information technology resources and expertise are not infinite, particularly in the face of increasing regulatory reporting and data requirements, and banks should not be required to divert their focus from such crucial endeavors absent significant incremental benefit to national supervisors. Accordingly, the Basel Committee should clarify that the templates included in the guidelines are merely suggestions and that national supervisors are expected to exercise discretion in determining whether to use, not use or revise those templates. National supervisors, in turn, should be encouraged to satisfy themselves (and provide their analyses to the industry for feedback and additional dialogue) regarding the materiality of certain data elements to the overall goal of monitoring systemic stability and the ways in which such information will be used to monitor systemic risk. Further, any such requirements should not be required by the Basel Committee and national authorities until at least one year following adoption by national regulators of the final templates and instructions, so as to provide banks with the appropriate time to finalize the development and testing of the appropriate reporting systems to provide the information to be required by the final templates.

We also believe it would be beneficial for the Basel Committee to make the following revisions and clarifications to Template 1:

- Immaterial entities: Section (a) would require banks to report “[e]ntities that were deemed immaterial during the step-in analysis.”³⁹ We believe Section (a) should be deleted as it would require banks to report irrelevant information about immaterial entities to their supervisors. Likewise, the right-most column should be deleted, as it would require explanations of assessments only for entities reported in Section (a). If, however, the Basel Committee retains Section (a), the right-most column should nevertheless be deleted because explanations appearing in a summarized tabular format would not provide meaningful information to supervisors, and supervisory assessments of a bank’s application of materiality criteria are more appropriately addressed through supervisory reviews of a bank’s framework to identify step-in risk.
- Other entities: Section (b) would require banks to report “[e]ntities that are material but step-in risk was estimated not significant.”⁴⁰ Section (b) would, in many cases, require banks to provide information about entities that is already addressed in other regulatory reports. For example, in the United States, the Federal Reserve has implemented Form FR Y-6, which annually requires banks to provide, among other

³⁹ *Id.*, at Annex 1.

⁴⁰ *Id.*

things, an organizational chart that includes a broad scope of entities, including unconsolidated entities controlled by the bank, as well as unconsolidated entities in which the bank has a stake of 5 percent or greater. Accordingly, national supervisors should be encouraged to evaluate whether Section (b) would result in their receiving meaningful incremental information, and, if they conclude that it would not, to delete Section (b) from the templates implemented in their respective jurisdictions.⁴¹ We also believe that Section (b) should be revised to state “Entities that are material but step-in risk was **not present**.” This clarification would reflect that, under the framework, a bank may determine that there is no step-in risk with respect to entities that are not excluded from analysis, and that, with respect to such entities, there is no need for banks to engage in any exercise to “estimate” step-in risk.

- Asset size: the middle column would require banks to report the “[t]otal asset size of the entities”⁴² listed in the template. It is unclear what “size” refers to (*e.g.*, on-balance-sheet or off-balance-sheet measures, or cash or synthetic/derivative positions), and the Basel Committee should clarify how banks would be expected to determine and report “size”.
- Typical contractual exposures: another column would require banks to report the “[t]ypical contract exposures to the entities”⁴³ listed in the template. The template appropriately contemplates that a bank may aggregate certain similar entity types in a single line item, and we believe the template should be revised to clarify that banks have the flexibility to determine the suitable methodology to use when determining and reporting the typical contract exposure for the entities reflected in the line item. This flexibility would allow banks to present typical contract exposure in the manner they consider most meaningful, which could, for example, be expressed as a range, median or average, depending on the relevant circumstances.
- Out-of-scope entities: The lead-in text before the template notes that certain entities outside the scope of a bank’s step-in risk analysis need not be reported. The lead-in text should be revised to note that immaterial entities need not be reported and that if other entities, such as the asset management counterexamples, are excluded by the Basel Committee or national supervisors such excluded entities should likewise not be reported.

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⁴¹ See Federal Reserve, *Instructions for Annual report of Holding Company (Reporting Form FR Y-6)* (version as of December 2016), at GEN-6, available at https://www.federalreserve.gov/reportforms/forms/FR_Y-620161231_i.pdf.

⁴² Consultative Document, at Annex 1.

⁴³ *Id.*

The Clearing House appreciates the opportunity to comment on the Consultative Document. If you have any questions, please contact me by phone at (212) 612-9211 or by email at brett.waxman@theclearinghouse.org.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Brett Waxman", with a stylized flourish at the end.

Brett Waxman
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