A response by UK Finance to the

Basel Committee on Banking Supervision (BCBS) on:

Globally systemically important banks – revised assessment framework

June | 2024

UK Finance

1. Introduction

1.1. UK Finance is the collective voice for the banking and finance industry. Representing 300 firms, we are a centre of trust, expertise and collaboration at the heart of financial services, championing a thriving sector and building a better society.

1.2. We are pleased to respond to **BCBS's Consultation on GSIB framework**. A mixture of globally and domestic systemically important banks, GSIBs and DSIBs, have contributed to this response.

2. Recommendations

2.1. Banks do not support the GSIB framework being based on daily or month-end averaging, due to operational considerations (see 3.5 – 3.10 below) and on cost-benefit grounds.

2.2. We recommend that BCBS consider quarter-end averaging based on existing regulatory reporting or market disclosure items. Quarter-end figures can be a good reflection of a bank's risk profile over the financial year of assessment.

2.3. In the last 10 years the size and frequency of the data provided by banks, both regular and ad-hoc, to international and national regulators has increased significantly. Therefore, we believe that regulators have the information needed to undertake significant qualitative assessments, including any potential window-dressing concerns, without GSIB indicator data.

3. Background and Rationale

BCBS Working paper findings

3.1. The detailed findings on window-dressing behaviour in the consultation are set out in the accompanying Committee **working paper**, "*The G-SIB framework incentivises window-dressing behaviour: causal evidence from a quantitative impact study*" (the Working paper).

3.2. The study focuses on OTC derivative notionals and repos only. As OTC derivative notionals is one of three components that comprise the Complexity category, it contributes 6.7% (third of 20% of total Complexity category) to the overall GSIB score. Gross repos is a component within the Total exposure category and is about 10% of Total exposure, thereby contributing about 2% to the overall score. Taken together OTC derivative notionals and gross repos make up less than 10% of the overall GSIB score.

3.3. The Working paper "*adopts an empirical strategy that exploits the fact that the G-SIB framework generates heterogeneous window-dressing incentives across banks. Specifically, incentives depend on banks' proximity to the fixed bucket thresholds that* *determine G-SIB capital requirements. These buckets are relatively large and crossing a threshold implies a significant change in capital requirements that banks are subject to (between 0.5% and 1% of total risk-weighted assets). Banks that find themselves closer to these thresholds are more likely to be able to materially reduce their capital requirements by cutting year-end activity and dipping (or remaining) below these thresholds. Thus, these banks face greater incentives to window-dress their activity for the purposes of saving G-SIB-incurred capital costs*."

3.4. Prima facie it does not seem appropriate to move to daily averaging approach to tackle two components that make up at most 10% of the mechanical GSIB score. Nor does it seem appropriate to change the GSIB indicator framework so radically to address a potential problem in marginal number of banks around the capital threshold boundaries.

Operational considerations

3.5. The GSIB indicators are generally not used by banks for internal risk management or monitoring purposes.

3.6. GSIBs and DSIBs in many jurisdictions submit regulatory and financial data to national supervisors on a quarterly basis. Therefore, GSIB indicators, leveraging these quarter-end regulatory and financial data, could be produced on a quarterly basis.

3.7. The existing quarterly reporting process is supported by rigorous checks and balances. Banks have quarterly disclosure committees to govern published information and the committees derive comfort by reconciling information amongst different quarter-end data and could augment existing control and governance processes to do the same for GSIB indicator data based on quarter-end averages.

3.8. The consultation seeks daily, monthly and quarter end balances while inferring that daily averaging is the BCBS preference. The production of daily average G-SIB indicators is, from a practical point of view, an unfeasible task. Most G-SIB indicators are based on accounting measures and evaluation, which are not calculated daily. Banks' business is managed daily leveraging other data and indicators, which have only partial contact with indicators and measures used for accounting and G-SIB purposes. Firms have indicated that a move to daily reporting across GSIB indicators would be a large-scale project as the GSIB framework crosses different areas of banks. Banks will also require quality assurance and governance processes to support any external reporting based on daily averaging; this would also require significant investment.

3.9. Whilst raw daily data is available on components underlying some indicators, significant investment in systems and people would be required to develop these, including the need to perform and robustly allocate overlays, such as post model and accounting adjustments, which are in most cases quarterly processes.

3.10. Therefore, whilst a move towards quarter-end averaging would not be without cost or effort, given additional processes such as disclosure related assurance and governance, banks would be able to support the transition with sufficient time for implementation.

Potential window-dressing due to client behaviour

3.11. As identified by the Committee, the study focuses on OTC derivative notionals and gross repos as they have been identified as most sensitive to window-dressing behaviour, in part due to the high frequency and liquid nature of the markets they are traded in. To take this to its natural end, non-traded, illiquid and/or longer-term assets and liabilities cannot therefore be window dressed and any proposal to average indicators should exclude these types of business lines.

3.12. We agree with the Committee that averaging is not appropriate for 'flow' indicators. Further, other indicators and certain sub-indicators are also by their nature, are not susceptible to window dressing. For example, level 3 assets and customer lending are not exposures that banks could temporarily exit over a period end.

3.13. Given the relative nature of the calculation, window dressing GSIB indicators is difficult given how insensitive indicators are to the overall GSIB score. The illustration below showing each indicator's sensitivity to 1 GSIB point, taking GSIB framework denominators for 2022[1], highlights this. For example, to move a bank's GSIB score would require EUR51bn of leverage reduction which a bank could not realistically undertake.

	A	**B**	**C = B/A**
	Total G-SIB points in population	**Population indicator total (EUR'bn)**	**Sensitivity per G-SIB point (EUR'bn)**
Total exposures	2,000	102,639	51
Intra-financial system assets	667	10,123	15
Intra-financial system liabilities	667	10,298	15
Securities outstanding	667	16,084	24
Total payments	667	3,111,952	4,668
Assets under custody	667	194,784	292
Underwriting activity	333	6,534	20
Trading volume fixed income sub-indicator	167	217,034	1,302
Trading volume equities and other securities sub-indicator	167	222,946	1,338
Notional amount of OTC derivatives	667	610,812	916
Trading and AFS securities	667	3,616	5
Level 3 assets	667	679	1
Cross-jurisdictional claims	1,000	25,129	25
Cross-jurisdictional liabilities	1,000	21,068	21

[1] https://www.bis.org/bcbs/gsib/denominators.htm

3.14. It appears that BCBS have concluded that fluctuations of GSIB indicator balances are driven by window dressing despite evidence that a significant contributor is client behaviour, as part of end of year balance sheet 'tidy up' We think that BCBS should have considered the examples below:

Repos

3.14.1. **Volumes at year end**: The reduction of repo volumes towards year-end is explained by two key drivers: (i) counterparties reduce their risk by year-end (some securities lenders recall bonds they have lent during the year and investors tend to reduce their exposure at year end as liquidity decreases) (ii) reduction in interbank market is not specific to repos. To illustrate: (i) in Figure 1 (source: compiled from publicly available EU national treasuries data), volumes in secondary French and German government bonds are lower at year-end while repo are correlated to such activity. (ii) in Figure 2 (source: national treasuries) we see clearly reduced activity in December in terms of European bond issuance (in euro zone, GE, FR, SP and IT being the biggest contributors).

Figure 1:

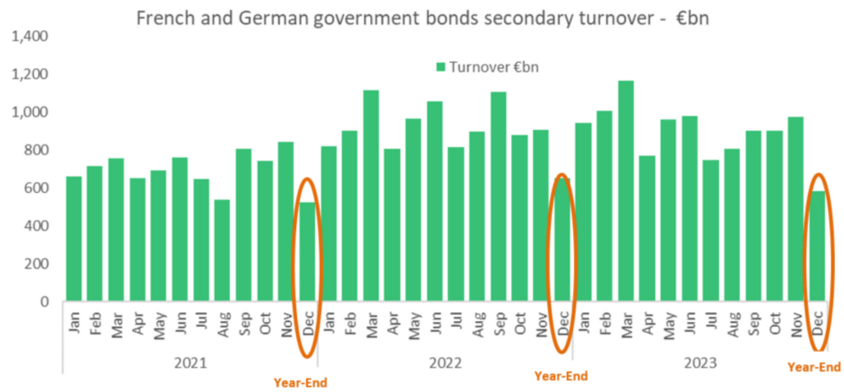
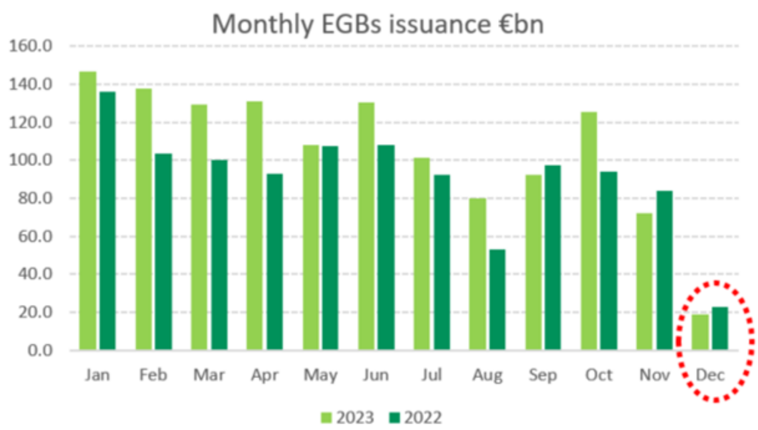


Figure 2:



3.14.2. **Pricing and profitability**: Higher prices due to specific year-end balance sheet costs, such as levies. Most repos are short-term transactions. Adjustments to prices to maintain economic profitability over year-end lead to reduced clients' demand. Certain counterparties are able to maintain their positions due to increased netting (e.g., better matching by counterparty and maturity date) while others elect to temporarily close their trades. Hence, the Figure 2 in BCBS WP42 graph 1a (Europe) only shows net exposure for repos (Size indicator in GSIB) while the same graph measured in terms of gross repos would have shown less variability.

Derivatives

3.14.3. Figure 3 in BCBS WP42 graph 1a (Europe) does not demonstrate any clear evidence of window-dressing for OTC derivatives. As explained previously for repos, reduction at year-end is mainly explained by less market activity driven by risk reduction by financial counterparties. In addition, OTC derivative notionals mainly comprise interest rate transactions which are by nature long-term transactions so cannot be reduced by year-end.

3.14.4. Furthermore, banks must perform multilateral compression cycles[2] with external providers (e.g. TriOptima) on a regular basis to reduce notionals by terminating trades while keeping risks within tolerances agreed with participants. These portfolio compressions reduce operational risk (e.g. managing too many cash flow payments) and are required under EMIR regulation[3]. Compression cycles are not related to window-dressing, it is mandatory for significant players, as it limits the level of risk and also occurs at year end.

Regulatory supervisory tools and access to data

3.15. Whilst the starting point for the determination of GSIBs is the GSIB indicators, there are also qualitative assessments by national supervisors and BCBS. "*The Basel Committee's assessment methodology for GSIBs requires a sample of banks to report a set of indicators to national supervisory authorities.... The scores and bucket allocations represent the outcome of the mechanistic elements of the G-SIB methodology* and *include the exercise of supervisory judgement. In the latter case a bank may be in a bucket despite its score being above or below the relevant threshold.*"

3.16. Therefore, there is room within the existing BCBS GSIB framework to exercise supervisory judgement selectively should there be evidence that a firm's systemic footprint as measured is not sufficiently addressed.

[2] *Portfolio compression is a post-trade netting technique through which market participants can modify or remove outstanding contracts and create new ones in order to reduce their overall market gross position without modifying their net positions*

[3] *Market participants with more than 500 over-the-counter (OTC) trades on their books are required to examine the possibility of performing portfolio compression twice a year*

3.17. As the GSIB framework includes supervisory judgement as a tool, if regulators have window dressing concerns, they should address this bilaterally through supervisory discussions rather than penalising all banks within GSIB framework evaluation.

3.18. In addition, in the last 10 years, the volume and frequency of data provided to national and international regulators have increased significantly. Therefore, regulators have all the information needed at quarter-ends and month-ends to undertake significant qualitative assessments without GSIB indicator data.

Thank you or considering our comments. We would be happy to discuss our response.

Responsible Executive

✉ nala.worsfold@ukfinance.org.uk

☎ +44 (0) 7384 212633