FÉDÉRATION
BANCAIRE
FRANÇAISE

2017.06.30

FRENCH BANKING FEDERATION RESPONSE TO BCBS d402 CONSULTATIVE DOCUMENT ON GLOBAL SYSTEMICALLY IMPORTANT BANKS - REVISED ASSESSMENT FRAMEWORK

The French Banking Federation (FBF) represents the interests of the banking industry in France. Its membership is composed of all credit institutions authorized as banks and doing business in France, i.e. more than 390 commercial, cooperative and mutual banks. FBF member banks have more than 38,000 permanent branches in France. They employ 370,000 people in France and around the world, and service 48 million customers.

The FBF welcomes the opportunity to share its comments on the BCBS's consultative document on revised assessment framework for Global systemically important banks.

The FBF reiterates its support for a stable and resilient global financial system, while facilitating economic growth. To this end, while we support the Committee's initiative to update and refine the methodology, we believe that the proposed amendments do not take sufficient account of the very significant changes that happened since the 2013 assessment methodology was published.

Banks are now much better capitalized and resolvable, riskier businesses and funding sources are less prominent, bank resolution schemes have progressed substantially, and Banking Union in Europe has significantly progressed. Accordingly, we believe that the cumulative amount of systemic risk in the banking sector has been reduced, especially in Europe.

However, the proposed amendments do not seem to reflect the sizeable reduction that has been achieved, and the same amount of systemic risk seems to be merely re-allocated across the cohort of G-SIBs. It does not consider either the migration or expansion of activities outside of the banking sector.

Accordingly, we believe the review of this methodology should reconsider the G-SIB footprint within the whole financial system, taking into account the improvement of the banking framework and the decrease of the banking sector importance within the financial system.

In this context, we believe the Committee should continue to pursue the objective assigned in 2013 to "*capture developments in the banking sector and any progress in methods and approaches for measuring systemic importance*," and to refresh and update accordingly.

We emphasize that non-bank activities should be regulated directly, not through banks exposures which further accelerate activities migration to the so called shadow banking. We stress also that structural changes should be immediately accounted not to unduly penalize banks, clients and growth.

Summary of the key comments:

- The FBF welcomes the removal of the cap on the substitutability category which is consistent with Basel Committee's previous messaging and will restore the level playing field.
- The FBF is strongly opposed to the expansion of the scope of consolidation to include exposures under insurance subsidiaries which is not consistent with the regulatory framework and would introduce confusion within the prudential framework.
- The FBF does not support the inclusion of derivatives exposures in the cross-jurisdictional indicators as it would overlap further with other indicators and lead to overstated requirements.
- The FBF does not support the inclusion within the substitutability category of a new indicator relative to the trading volume because such criteria is not reliable enough and does not seem to be appropriate either.
- The FBF has concerns with the provision to leave national authorities the discretion to require a bank to delay its release of HLA requirements, this will be at odds with a level playing field.
- The FBF broadly agrees with the other proposed changes made by the Basel Committee, specific comments are to be considered within our detailed answer.
- As for the discussion on STWF, the FBF deems its inclusion not to be appropriate as it would be duplicative with other BCBS standards, it would participate to acumulate requirements elaborated in isolation and lead to overstated requirements.

Please find our detailed comments below to the questions raised in the consultative document.

I- <u>**What are respondents' views on each of the proposed changes in the G-SIB assessment methodology ?**</u>

1. <u>Guiding principles for review of G-SIB assessment methodology</u>

The FBF welcomes the definition of guidelines linking the whole document. These high-level principles remind the purpose of the G-SIB assessment methodology and reflect a consistent and pragmatic approach, with the regulatory framework as well as with the institutions.

2. <u>Removal of the cap on the substitutability category</u>

The FBF welcomes the removal of the cap on the substitutability category, which was previously introduced in the G-SIB updated assessment methodology dated 2013 as a temporary exception. Indeed the current methodology failed to reduce the concentration in this area. The removal is consistent with Basel's previous messaging and will restore the level playing field.

3. <u>Expansion of the scope of consolidation to include exposures under insurance subsidiaries</u>

The FBF is strongly opposed to such proposal which is not consistent with the regulatory framework. Insurance is subject to proper regulation; any further improvement at international level should be suggested by the International Association of Insurance Supervisors (IAIS) and transposed into existing or future sectorial rules. Last but not least we consider that non-banking activities diversification contributes to smooth any potential banking failures as the risks are proven not to be correlated, it helps preserving good assets.

- **Call for a consistent regulatory framework :**

Insurance entities are outside the prudential scope of consolidation. For example, in the European Union this rule is defined in article 18 of the Capital Requirement Regulation. Besides the Task Force on Risk Consolidation of the Basel Committee, in its proposal on identification and management of step-in risk clearly states that insurance entities are presumed not to be included in the scope of the step-in risk, even if these entities are in the accounting consolidation perimeter. This confirms that the Basel Committee considers insurance entities outside the regulatory scope of consolidation.

In addition, given that the Committee mentions in the consultative document that it is conscious of the need to implement changes based on high-quality and readily available data, the proposal to include insurance subsidiaries into scope of G-SIB score calculation seems inconsistent with guiding principle n°2, as it will create mismatch and additional treatment for institution. As stated in the consultation guiding principle n°2, G-SIB calculation : The Committee willingness is *"to identify proposals that had a sound rationale, were **feasible to implement** ..."* with emphasis on "*any methodology changes that could be based on **high-quality** and **readily available** data. Otherwise, different interpretations or poor data quality may have negative repercussions for the stability of the overall assessment methodology*".

Since insurance exposure do not belong to the same regulatory framework than the banking ones, some specificities of the former one do not exist in insurance subsidiaries process. It is notably the case of securities eligible to L1/L2 liquidy HQLA levels. The LCR is not calculated on the insurances exposures. It means that, from a very operational point of view, the securities referentials do not present the required parameters to identify the eligible securities; the back/middle offices teams, as well as finance/risk teams of these entities do not have knowledge of this banking specific framework. Therefore, data is not "*readily available*", and will not be the required "*high-quality*" mentioned in the Consultative document before extensive works that do not qualify it as "*feasible to implement"*.

Lastly, the insurance sector has its own requirement to supervise systemic entities. The FSB has in fact separated the supervision of banks and the supervision of insurances, which has defined a requirement within the G-SII framework. The Basel Committee should not preempt the current ongoing work at the IAIS level regarding the G-SII framework.

- **Insurance entities are subject to their proper regulations :**

Regardless of whether insurance entities are independent or subsidiaries of banking groups, they are subject to a distinct sectorial regulatory framework.

This is particularly the case in the European Union, where insurance entities are properly supervised, regulated and are subject to a specific framework for resolution. Besides, to assess the systemicity of a banking group owning insurance entities, those groups forming financial conglomerates are subject to the EU directive on supervision of financial conglomerates.

Should certain jurisdiction members lack a proper regulatory and supervisory framework around these activities, they should first address this shortfall within their jurisdiction before any potential top up clause at international level which would otherwise penalize twice activities already covered in regulated jurisdiction.

- **The subsequent economic risk of insurance activities is not comparable with banking activities:**

Furthermore, insurance and banking activities provide diversification benefit. In a situation of stress on the banking sector, insurance companies are indeed likely to be spared by any systemic crisis as their risk nature differs from that of banks. Numerous studies have shown that banking and insurance risks exhibited little positive correlation.

As summarized by the ECB in its December 2009 Financial Stability Review , "this is mainly because most insurers' balance sheets, unlike those of banks', are composed of relatively illiquid liabilities that protect insurers against the risk of rapid liquidity shortages that can and do confront banks."

Indeed insurance activities are governed by the structure of their liabilities, that can include some long term commitments of remuneration, and are for this reason sensible to long term variation of the economic environment, especially interest rates. Banks activities are more oriented to intermediation: credits are financed through a redistribution of liquidity, derivatives are hedged. Most of the risk coming from the banking activity is related either to the default of its clients or to the residual risk arising from unhedged portion of risks. This is thus a short term risk, and a long list of academic studies show that those activities have a very different behavior within the business cycle, they are countercyclical, and they are strongly diversified with each other. Hence the insurance subsidiary can bring stability to the bank by reducing the risk of failure and the LGD in case of default.

In fact several banks have experienced that during the crisis, their insurance subsidiary has continued to perform well when the banking arm was incurring losses, and this is certainly one of the reason why

French universal banks have managed to pass through the crisis better than other peers, and without much help from the state. This strong performance and the added value of an insurance subsidiary that can be sold in resolution should be considered as positive and lead to a reduction of the G-SIB buffer. On the contrary, the new proposal will lead to a penalization and a potential increase of the G-SIB buffer, which is precisely the opposit of the lessons learned from the crisis.

Should the Basel Committee be willing to address the issue of systemicity of insurance activities, or the risk that insurance performs shadow banking, we think that this has to be tackled through specific sectoral rules and not by further constraining banks for risks that are outside the scope of banking risks, as is already the case with two different regulations. The reason is that insurance activity is very different from bank activity, its regulation focuses also on the commitment given to the client because it plays an essential role: the size of the balance sheet for an insurance activity does not have the same meaning than for banks since some of the assets are invested on behalf of clients, and at the end it is the client that will bear some of the losses. Adding assets of liability of the bank and the insurance do not have much sense. The Basel Committee, jointly with the IAIS, should rather identify those jurisdictions where there is a clear need to reinforce sectoral rules for insurance activities.

4. <u>Amendment to the definition of cross-jurisdictional indicators</u>

Derivative exposures

We support the desire to use higher quality and harmonised data however, we believe there is an overlap in the inclusion of derivative exposures across the different categories in the assessment methodology which justify not proceeding further.

It should be noted that derivative exposures are already captured via the complexity, size and interconnectedness categories. Therefore, the risk which is being captured through the inclusion of derivatives has already been capitalised and should not be accounted for once more i.e. derivative exposures should be excluded from the cross-jurisdictional activity.

At least, OTC derivatives market reforms should be recognized. Substantial amounts of derivatives trading are now centrally cleared through central counterparties, reducing the systemic risks resulting from bilateral trading, which was not the case when the current G-SIB assessment methodology was finalized. Therefore, centrally cleared derivatives should be exempted.

As for the non-centrally cleared derivatives, if the BCBS decide to include them despite double counting that it would imply, we think that derivative exposures to non-financial corporations should be distinguished.

We are also wondering wether the BIS collection refered to by the Committee is now allowing to neutralize the historical accounting difference between US GAAP and IAS in term of netting. Indeed such a difference would be detrimental to level playing field.

In addition, we believe that a key issue with the existing methodology has not been addressed through the proposed changes which require higher attention:

The proposed revision to the definition of cross–jurisdictional indicators should encompass the proper recognition of the Banking Union (Eurozone) as being a prudential reality.

One of the underlying objectives of the cross-jurisdictional indicator was to take into account the risk that the resolution of a multi-jurisdiction banking group would be technically more difficult in case of failure, and that an additional capital buffer was therefore warranted. According to the BCBS: "*The greater a bank's global reach, the more difficult it is to coordinate its resolution and the more widespread the spillover effects from its failure*". But, since the Banking Union is now a single supervised jurisdiction thanks to the Single Supervisory Mechanism (SSM) and Single Resolution Authority (SRM) set up, this risk is no longer relevant for intra-Eurozone transactions. We note also that this was anticipated by the Committee itself: "*As regards the structural changes in regional arrangements – in particular, the European Union – they will be reviewed as actual changes are made*."

Intra-Eurozone activities should therefore no longer be taken into account in the measure of cross-border activity considering the unique banking regulation (Single Rule Book) as well as the uniqueness of supervisor for on-going activities (SSM) and gone concern ones (SRM). As a matter of fact, cross-border activities within this area are significantly less risky and complicated than cross-border activities with a third country. Consequently, the current framework largely overstates the systemic importance of intra-Eurozone activities to the detriment of an accurate identification of systemic risk and which penalise European economy.

We urge the Committee to review the cross-jurisdictional definition in order to take into account these changes and end the unintended consequences it has on the financial stability monitoring as well as on the economy.

5. Inclusion of a new indicator of trading volume

The FBF does not support the inclusion within the substitutability category of a new indicator relative to the trading volume for the following reasons:

- It will be quite difficult to follow such criteria which is neither clearly defined nor reliable (in contradiction with Principle 2 that calls for changes that should be both sound and implementable);
- Underwriting is much more suitable to this category as it is an activity where there are important barriers to entry of new actors and banks that are active on the secondary market are generally active on the primary market as well;
- Additionally, the Consultative Document states that trading activities of banks sustain market liquidity and a disruption to market liquidity can lead to dislocation of markets. We believe the issue of market liquidity is adequately dealt with in the prudential framework, any additional requirements in this area would only lead to margin pressure on trading activity, which would reduce further market liquidity - the very area this indicator is aiming to protect.

6. Revision to the disclosure requirements

Generally speaking, disclosures have to be homogenous in their nature. However it should be clarified that banks are not required to publish provisional indicators, which might be different from those used by the Basel Committee to perform its assessment.

7. Further guidance of bucket migration and associated HLA surcharge

The FBF agrees with the Basel Committee proposal to allow banks to immediately release the HLA requirement in circumstances where the G-SIB score falls. However the provision to leave national authorities the discretion to require a bank to delay its release of HLA requirements should be removed in order to maintain a level playing field.

8. Schedule

The FBF agrees with the Basel Committee proposed schedule. However any delay of finalization of this revised methodology should be accompanied by an update of the initial schedule in consequence.

II- What are respondents' views on potentially including STWF as an indicator in the interconnectedness category ?

While the FBF acknowledges that a concentration of short-term funding can be a source of liquidity risk, we do not consider the inclusion of such a measure in the GSIB methodology to be an appropriate policy response. We believe this indicator is not relevant as the risks that it targets are addressed by other areas of the prudential framework and therefore would result in overstated requirements.

The risks posed by an over-reliance on short-term wholesale funding have been addressed by the Basel framework's liquidity reforms, the LCR and the NSFR. These requirements, together with heightened market expectations, have driven great improvement in banks' liquidity management since the crisis, and the implementation of the NSFR in 2018 will continue this, and ensure it is maintained. Banks and supervisors in each jurisdiction are currently making huge efforts to ensure NSFR implementation and compliance.

Consequently, the existing Basel III framework already has short-term wholesale funding factor addressed within its in scope, directly disincentivizing banks from relying on such funding sources. The BCBS was right to address that issue, but it has done so, and this new proposal unnecessarily conflates liquidity with capital, and introduces a new measure when an effective one is already in place.

We also note that the consultative document suggests that the inclusion of this factor will have little or no impact on individual bank G-SIB scores, which just underlines the unnecessary nature of the move when more effective tools are already in place.

The consultative document states that the NSFR (and LCR) may lack the flexibility needed to limit social losses. However, we don't see how including the short-term wholesale funding factor into the framework adds any flexibility or would change that suggested situation. It merely adds duplication.

Since the financial crisis, banks have equipped more capital, reserved more liquidity and become more resolvable with an effort to be compliant with higher capital requirement of the post crisis financial regulatory reform. The G-SIB designation framework is targeting such better capitalized and resolvable entities.